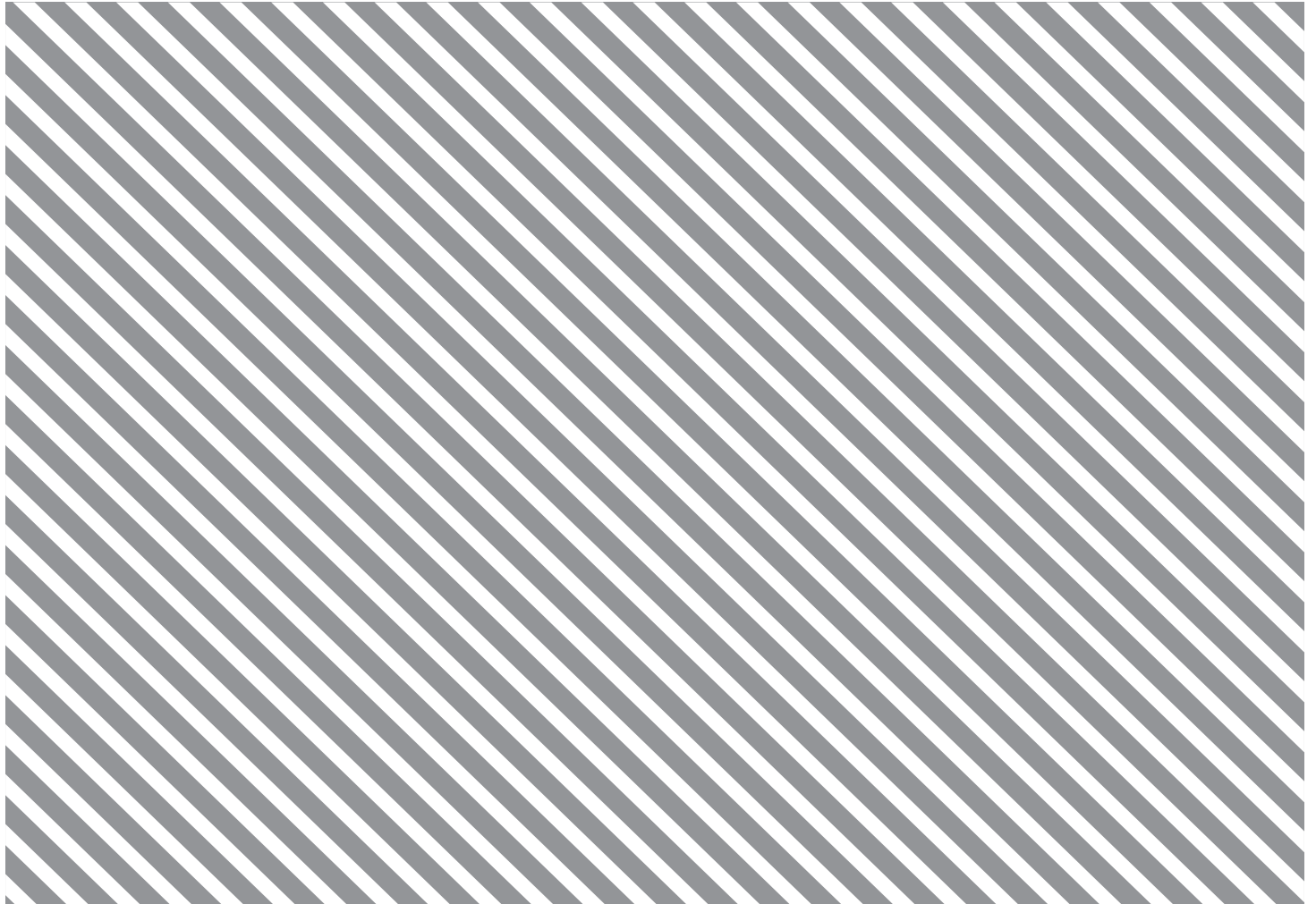


White Paper

# Integrated Corporate Governance: A Practical Guide to Stakeholder Capitalism for Boards of Directors

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# Preface



**Klaus Schwab,**  
Founder and  
Executive  
Chairman, World  
Economic Forum

We are pleased to present this White Paper examining the practical implications of stakeholder capitalism for corporate governance and Boards of Directors in particular.

In advance of the World Economic Forum's 50th Annual Meeting in January of this year, the Forum updated and reissued its 1973 Davos Manifesto, articulating the principles of stakeholder capitalism. The stakeholder concept remains our guiding philosophy and was reflected in the theme of the meeting, Stakeholders for a Cohesive and Sustainable World.

Events since then have underscored the relevance of these principles for the governance of companies and other organizations. The COVID-19 pandemic and resulting humanitarian and economic crisis have reminded us that firms are themselves stakeholders in the sense that they have an intrinsic interest in and shared responsibility for the resilience and vitality of the economic, social and environmental systems in which they operate.

The pandemic crisis has illustrated in dramatic fashion the need for a fundamental shift in corporate governance that has been gathering force for some time. The White Paper describes how the Fourth Industrial Revolution and other major changes in the operating context of business over the past two decades have been eroding the traditional distinction between corporate governance and corporate responsibility, leading well-governed firms in effect to integrate the two. It argues that such integrated corporate governance is the essence of stakeholder capitalism and presents a structured set of best practice guidance for Boards seeking to diligently serve the interests of shareholders and other stakeholders simultaneously in the core strategy and governance of their firms.

The paper highlights several relevant governance frameworks that have been developed by business leaders with experts and other stakeholders on the Forum's platform in the past few years. These best practices are tools to help Boards place the principles of stakeholder capitalism into practice in their firms. They include the International Business Council's recent leadership initiatives on long-term investment, common environmental, social and corporate governance metrics, lighthouse public-private partnership projects and climate change targets; Board toolkits created by Forum communities in the areas of cybersecurity, artificial intelligence and climate governance; and the Forum's recent Stakeholder Principles in the COVID Era and related Workforce Principles for the COVID-19 Pandemic. The White Paper places these and other good governance frameworks into a six-part leadership agenda for Boards seeking to absorb the larger lesson of the COVID-19 crisis and "walk the talk" of stakeholder capitalism going forward.

I would like to express appreciation to the authors, my Managing Board colleague Rick Samans and from Harvard, Jane Nelson, who is a longstanding and highly valued collaborator, for their important contribution to this critical debate. It is our shared hope that the concepts and examples in the paper will help more Boards embrace the principles on which the Forum was founded in ways that strengthen and render more sustainable the value created by their firms.

Geneva, June 2020

# Executive summary

The role of company Boards of Directors has never been more crucial – and under review. The major technological, environmental, geopolitical and socio-economic changes of the past two decades, together with the global humanitarian and economic crisis resulting from the Covid-19 pandemic, are driving a re-examination of corporate governance principles and practices, just as they are posing fundamental challenges to public governance.

This profound shift in the operating context of companies is rendering environmental, social, governance and data stewardship (ESG&D) considerations increasingly material to the fundamental purpose of companies – sustainable value creation. As a result, it is eroding the traditional distinction between a shareholder primacy model of corporate governance focused on financial and operational risks and opportunities, on the one hand, and a stakeholder-driven model of corporate responsibility and citizenship focused on environmental and social risks and opportunities, on the other. The heightened materiality of ESG&D factors requires them to be more fully integrated and internalized into the core strategy, operations and governance of companies rather than segmented and *de facto* subordinated, as they too often are today.

Such *integrated corporate governance* is the essence of stakeholder capitalism. It is what is required to give practical effect to the vision and principles articulated in the World Economic Forum's 1973 *Davos Manifesto* and, more recently, in a growing number of regulatory and voluntary frameworks around the world. These range from changes in company law and corporate disclosure requirements in a variety of countries to the US Business Roundtable's revised *Statement on the Purpose of a Corporation*<sup>1</sup> in August 2019, and the Forum's updated *Universal Purpose of a Company in the Fourth Industrial Revolution*.<sup>2</sup>

Integrated corporate governance departs from the mindset and associated practices of shareholder primacy and corporate responsibility, which have regarded ESG&D factors as primarily non- or pre-financial matters. Instead, it takes a holistic view of shareholder and wider stakeholder interests by systematically internalizing ESG&D considerations into the firm's strategy, resource allocation, risk management and performance evaluation and reporting policies and processes. It does so not for ethical or political reasons, although these are crucial factors that must also be addressed by Boards, but out of a recognition that business value creation beyond the near term is increasingly dependent in the 21st century upon a rigorous understanding and active management and governance oversight of these risks and opportunities.

## 1. The changing operating context for business

In all countries and industry sectors, the business community is facing fundamentally new and more complex and systemic risks and opportunities. Boards must equip themselves with the information and know-how to understand and act upon the shifts that are underway and the impact that these will have on their company's performance, licence to operate and resilience.

### ***Technological, environmental, geopolitical and socio-economic shifts***

Transformation in all of these areas is giving birth to a new phase of industrial development, the **Fourth Industrial Revolution**, and global economic interdependence, **Globalization 4.0**. The trajectory of these major transformations and their impact on the future of jobs, social and economic inclusion, environmental sustainability and political stability, will depend in large measure on how well governance adapts at multiple levels – corporate, governmental and global. For companies, they are changing the nature of value creation, risk and societal expectations in ways that challenge the traditional understanding of both corporate governance and corporate responsibility.

### ***The growing materiality of ESG&D stewardship risks and opportunities***

As a result of these fundamental shifts, ESG&D issues are becoming more material to companies in every sector. While the specifics may differ based on industry and circumstances, ESG&D risks and opportunities have rising potential to affect a company's current and future financial condition, operating performance, competitiveness and in certain cases, survival. The ability of companies to address issues such as climate change, natural resource scarcity, human rights, inclusion and diversity, data protection and privacy and to be resilient in the face of natural and economic shocks increasingly impacts their ability to create and sustain economic value and to manage risks and preserve value.

### ***The evolution of corporate governance and corporate responsibility***

The paradigm of shareholder value maximization and primacy is starting to shift. While the ability for companies to be profitable and deliver measurable value for shareholders remains essential, a growing number of leading CEOs, investors, regulators, activists and academics are calling for companies to make an explicit and measurable commitment to harmonize the needs of all key stakeholders, including but not only shareholders. They are also calling on companies to set public goals and targets for managing material ESG&D risks and opportunities, and to disclose their performance against these, as well as demonstrate their strategies for delivering long-term in addition to short-term value.

## ***Towards stakeholder capitalism through integrated corporate governance***

Stakeholder capitalism holds great promise for both shareholders and society at large. By better internalizing factors that influence value over time, it could generate stronger and more resilient financial returns for the ultimate owners of companies: people with retirement and other savings accounts intended to fund medium- to long-term family needs. At the same time, it could accelerate progress towards the larger aspirations of society, such as combatting climate change, reducing inequality, building resilience to shocks and advancing sustainable development more broadly.

The leadership imperative for Boards and executive teams is to translate the principles and goals of stakeholder capitalism into practice. In particular, Boards must transcend the traditional segmentation of shareholder and stakeholder considerations – exemplified by the concepts of shareholder primacy and corporate responsibility – by integrating them. Integrated corporate governance takes a holistic view of shareholder and wider stakeholder interests by systematically internalizing ESG&D considerations into the firm’s strategy, resource allocation, risk management and performance evaluation and reporting processes.

If stakeholder capitalism is to be more than an optimistic vision, it will require this integration and internalization to become better defined in operational and governance terms and such practices adopted in widespread fashion by Boards. The six-point agenda for Board leadership highlights key areas for action that all Boards should address, regardless of industry sector, jurisdiction or ownership structure.

**“Boards must transcend the traditional segmentation of shareholder and stakeholder considerations – exemplified by the concepts of shareholder primacy and corporate responsibility – by integrating them.”**

## **2. A Board leadership agenda for integrated corporate governance**

To be fit for the purpose of creating sustained and shared value in this new era, Boards must rigorously reassess their capabilities and priorities in the following areas of oversight and governance responsibility. In many cases, significant changes will be required:

### ***#1: Align strategy and capital allocation with drivers of long-term value creation***

Boards must align their strategic and particularly capital allocation priorities with key drivers of sustainable, long-term value creation in the Fourth Industrial Revolution. This requires enhancing their focus on intangibles such as talent development, corporate culture, research and development, innovation and branding as well as reinvestment in productive assets and capabilities that can deliver short term results while also investing for sustainable long-term growth. In 2017, the World Economic Forum’s International Business Council created

the *Compact for Responsive and Responsible Leadership*, which provides guidance on achieving these goals, and it developed a measurement framework to help managers assess key financial drivers of long-term value creation such as investment, relative earnings per share growth, ratio of dividends and buybacks to net income and leverage factors. Together with improved incentives, metrics and reporting on non-financial drivers, this broader approach to setting strategy and capital allocation priorities can help to support investor-corporate relationships which are focused on stronger long-term value creation.

### ***#2: Internalize material ESG&D factors in enterprise risk management***

As part of their risk oversight responsibility for material operational, financial, reputational and regulatory risks that their company or a particular business unit, project or product needs to address and mitigate, Boards must gain understanding of rapidly evolving environmental, social, governance and data stewardship risks. They must be able to provide oversight on the risks these pose to the company’s own financial condition and operating performance as well as the risks their company’s activities pose to people and the environment.

Climate change is a growing issue for all Boards and investors and regulators are increasingly calling on them to implement the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD). Water insecurity, pollution, land use and biodiversity are other environmental factors of increasing materiality to most companies. In terms of the “S”, respect for human rights, tackling inequality, and supporting inclusion and diversity, health and safety, and skills for the future are key themes. Governance issues include clarity around corporate purpose, ethics, compliance, anti-corruption, tax payments and political engagement. And, key data stewardship priorities for Boards are cybersecurity, the use and governance of artificial intelligence and machine learning, and privacy and data ownership issues associated with data collection, management and use.

### ***#3: Strengthen preparedness and resilience to crises and systemic shocks***

Boards play an increasingly crucial role in providing oversight on the company’s ability to respond to and recover from systemic risks and shocks, ranging from financial crises, recession and political conflicts to natural disasters, the impact of climate change and pandemics. In terms of improving preparedness, there is a need to undertake more regular and sophisticated scenario analysis and horizon-scanning activities, to ‘stress-test’ the company’s resilience against shocks that may have system-wide implications, and to put emergency succession plans in place for mission critical roles at both the executive and operating level. In a crisis management situation, the Board’s role is to support management in putting people first, especially the health and safety of employees and other stakeholders, supporting critical functions and operations for business continuity, and providing oversight of financial risks and resilience. As soon as possible, Boards should be engaging with management to explore recovery options, changes that might be needed to strategy, and opportunities for building future operational, cultural, financial and technical resilience.

#### **#4: Engage the firm in cooperative efforts to strengthen its operating environment**

Boards have a material stake in the viability and hence stability of their company's operating context, particularly with respect to the strength of the social fabric and the norms and public institutions that underpin the functioning of rule of law, respect for human rights, and fair and efficient markets in the jurisdictions in which they have significant operations.

For example, they should engage with management to shape ways for the firm to invest in education and training to prepare the future workforce and support a just transition for people whose jobs and livelihoods will be affected by automation, restructuring, the transition to low carbon economy and other fundamental economic shifts. Second, they should review the firm's global tax policies and practices to ensure **fair payment of corporate taxes** that are needed to support public goods and services and effective public institutions. Third, they should identify areas where the company can play a role beyond its own operations in tackling structural inequality and injustice based on income and/or race, religion, nationality, gender, sexual orientation and other forms of personal identity, for example through investments and advocacy to expand economic opportunity and advance social justice. Fourth, Boards and management should consider how their companies can contribute to **collective public priorities** such as the Sustainable Development Goals and the Paris Climate Agreement as well as building resilience to potential systemic economic and natural shocks, including through policy dialogue and advocacy in support of these goals.

#### **#5: Prepare the company's mainstream reporting in an integrated manner**

There is a growing imperative for Boards and management to prepare the company's mainstream disclosures in an integrated fashion that combines financial reporting with reporting on material ESG&D risks and opportunities. The increased financial materiality of these factors requires well-governed corporations to reflect them in their mainstream disclosures and to ensure greater transparency and accountability to investors and other stakeholders by setting public targets, providing independent assurance on performance against these targets and analysis of strategic risks and opportunities.

Working with Deloitte, EY, KPMG and PWC, the Forum's International Business Council is spearheading an effort to identify a **core set of ESG metrics** that are common across industry sectors, which can be integrated into mainstream reporting on a consistent and comparable basis. In addition, initiatives such as the Task Force on Climate-Related Financial Disclosure (TCFD), the Sustainability Accounting Standards Board (SASB), Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI) and CDP are providing guidance on more issue or sector-specific disclosure priorities. All Boards should be familiar with and able to provide oversight on the evolving agenda for corporate reporting and accountability.

#### **#6: Adapt the Board's organization, composition and engagement to these imperatives**

Boards need to evaluate best practices for integrating these issues into the way they are structured and organize their work, into their current and future membership, and into their engagement with key internal and external stakeholders. A key area for review is the appropriate integration of ESG&D oversight into different Board Committee charters and the establishment of a dedicated Board committee to address these issues. Likewise ensuring the right balance between Committee-based work and integrating these issues into full Board discussions on corporate purpose and culture, strategy, risk management and risk tolerance, business planning, target setting and performance oversight, major investment decisions, and executive compensation and succession planning. Boards increasingly need to review their diversity in terms of skills, experiences, gender, race, nationality and age. And, they need to review effective models for engaging with internal stakeholders, including but beyond the company's executive management team, as well as external stakeholders from investors to community and government leaders.

## **Conclusion**

This paper outlines an action agenda for integrating and strengthening Board governance in these six domains, each of which has an increasingly important bearing upon the performance, licence to operate and resilience of companies, whether they are publicly, privately or state owned. The paper does not focus on the relative challenges or benefits of different corporate ownership structures as they relate to integrating stewardship of ESG&D issues. Nor does it analyse and compare the different models of corporate governance around the world.

The six point agenda for action is aimed to be relevant for consideration by any Board regardless of jurisdiction, ownership structure and model. It is a call to action and practical resource for Boards seeking to keep pace with changing economic circumstances and social expectations – to “walk the talk” of stakeholder capitalism. If business is to restore and sustain public trust and if stakeholder capitalism is to be more than an optimistic vision, Boards must integrate these principles and practices across industry sectors and countries. In today's world, such integration is essential to create long-term sustainable value for shareholders and other stakeholders alike.

**“ A call to action and practical resource for Boards seeking to keep pace with changing economic circumstances and social expectations – to “walk the talk” of stakeholder capitalism. ”**



# I. The changing operating context for business

In all countries and industry sectors, the business community is facing fundamentally new and more complex and systemic risks and opportunities. This section provides a brief overview of some of the most substantial shifts under way, the associated growing materiality of environmental, social, governance and data stewardship (ESG&D) issues for business, and recent changes in corporate governance and corporate responsibility in response to these changes. It concludes by outlining the need for a more integrated approach to corporate governance going forward to enable Boards and their companies to be successful and resilient in the future.

## 1. Technological, environmental, geopolitical and socio-economic shifts

Over the past two decades, the technological, environmental, geopolitical and socio-economic context in which major companies operate has changed fundamentally. This fourfold transformation is giving birth to a new phase of [industrial development, the Fourth Industrial Revolution](#),<sup>3</sup> and [global economic interdependence, Globalization 4.0](#).<sup>4</sup> The trajectory of these major transformations will depend in large measure on how well governance at multiple levels – corporate, governmental and international – adapts. For companies, they are changing the nature of value creation, risk and societal expectations in ways that challenge the traditional conception of both corporate governance and corporate responsibility.

### **Technological**

Economic activity has become much more knowledge intensive and geographically integrated as the digital economy and globalization have taken hold over the past two decades. It will become even more so as the next phase of automation, connectivity and market integration – the Fourth Industrial Revolution – unfolds over the next 20 years. The massive scale and exponential speed of technological change and the growing convergence between digital, physical and biological technologies are creating fundamentally new risks and opportunities for companies in every industry sector. These secular forces are transforming corporate value creation and competitive advantage, making them increasingly dependent upon intangible capital formation, particularly innovation, talent development and branding. These usually require investment over a sustained period, a considerably longer time span than that required for two value creation strategies that have been in vogue for the past generation: profit optimization and shareholder value maximization.

In today's economy, for many industries the time to market and agility in response to changes in customer requirements are increasingly important sources of competitive advantage. These have begun to induce a reshoring and reintegration of production as automation reduces the share of labour in the total cost of production.

In addition, after a decade of extraordinarily low interest rates in much of the world, most companies have reached the point of diminishing returns from increased leverage. The result of these trends will be to place a growing value creation and thus corporate governance premium in the years to come on *investment* in intangibles, such as innovation, talent development and branding, as opposed to the *rationalization* of assets and overhead through restructuring, outsourcing and financial engineering.

### **Environmental**

In the four years since the UN Paris Agreement on climate change was negotiated, there has been a major shift in social attitudes, energy markets, regulatory agendas and consumer and investor preferences with respect to the need to take urgent action on addressing climate change. These trends are accelerating and they require companies to think more deliberately and strategically about the risks and opportunities climate change and an energy transition pose to their current operations and plans for the future from the perspective of both mitigation and adaptation. Indeed, both regulators and investors are rapidly moving to require firms to integrate climate change considerations into corporate governance, strategy and disclosure, in recognition that related physical and transitional risks can have major implications for corporate performance and in some industries, survival.

The [Network for Greening the Financial System](#), which consists of 51 national financial regulatory bodies and 12 international institutions, recently encouraged “all companies issuing public debt or equity as well as financial sector institutions to disclose in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations”. And, more than 340 investors with nearly \$34 trillion in assets under management have committed to engaging the world's largest corporate greenhouse gas (GHG) emitters to strengthen their climate-related disclosures by implementing the TCFD recommendations.<sup>5</sup>

While climate change has been the “game changer” in terms of putting environmental issues more firmly on the boardroom agenda, other environmental issues are also rising up the Board agenda. They include the related and escalating challenges of water insecurity, biodiversity loss and a growing public backlash against pollution, ranging from a severe deterioration in air quality in certain cities to plastics in the ocean.

### **Geopolitical**

The growing multipolarity of international relations and return of overt great power rivalry are contributing to a pluri-lateralization of the world economy – a fragmentation of international trade and investment driven by politics. Uncertainty and complexity are on the rise, requiring multinational firms to take a more deliberate approach to assessing geopolitical and policy risks, including the threat of finding themselves caught in the middle of trade, investment and migration disputes or technological competition between major countries and trading blocs. Some countries are instituting new barriers to cross-border flows of investment, natural resources, people and data, reflecting a decline in trust among nations and the tendency of international rule-making to lag changes in the world economy.

### **Socio-economic**

As automation and globalization have increased economies of scale and industrial restructuring, income inequality and worker insecurity have risen in many countries. Combined with deep-seated existing structural inequalities, the disproportionate social and economic costs borne by low-income workers and households during the global financial crisis and Covid-19 pandemic and tensions over migration, these forces have created a popular sense that economies are not working sufficiently for the benefit of the majority and have led to protests and civil unrest in a number of countries. The social consensus underpinning open, pro-growth economic policies and capitalism itself has eroded, as has trust in corporations, which often serve as the agent and public face of such disruption.

As governments struggle to respond to these socio-economic and political challenges, companies are faced with rising expectations regarding their role in contributing to the general welfare of their workers and communities. In addition, while they offer many benefits to society, the dramatic increase in the use of certain digital technologies poses new challenges to human rights, from the use of mass surveillance technologies and data privacy to hate speech. As such, companies that produce or use these technologies are under growing pressure to demonstrate that they understand and are mitigating the risks posed to people that might cause or enable complicity in human rights abuses.

In a climate of increased social fragility and diminished trust, a lapse by an individual company, for example an incident relating to customer data, corruption, labour rights or environmental pollution, is more likely to escalate into a crisis, potentially to the point of threatening a firm's very existence. This is particularly the case if a company already suffers from a deficit of trust because of a perceived track record of insensitivity to or degradation of the social context in which it operates.

### **Systemic shocks and crises**

Systemic shocks and crises that cause substantial losses and disruption for millions of people are clearly not new. The enormous humanitarian and economic toll of two World Wars and the Great Depression are obvious examples. Yet, as a result of the transformational shifts outlined in this section, the frequency, speed and in some cases the

scale of natural, humanitarian and economic or financial crises and system-level shocks have increased over recent decades. In most cases a natural or humanitarian crisis leads to substantial financial and job losses, and vice versa. Consider the following:

- **Epidemics and pandemics:** A prescient 2019 report by the World Economic Forum noted, “On the 100th anniversary of the 1918 influenza pandemic, it is tempting to believe the world has seen the worst epidemics. However, with increasing trade, travel, population density, human displacement, migrations and deforestation, as well as climate change, a new era of the risk of epidemics has begun. The number and diversity of epidemic events has been increasing over the past 30 years, a trend that is only expected to intensify. ...outbreaks and epidemics are also causing more economic damage when they occur.”<sup>6</sup>
- **Natural disasters:** Research by both academics and practitioners highlights increasing concerns. For example, according to Aon's 2019 annual Weather, Climate and Catastrophe Insight report, “The decadal period from 2010-2019 marked the costliest in the modern record for global natural disasters on a nominal and inflation-adjusted basis. Total direct economic damage and losses tallied USD2.98 trillion. This was USD1.1 trillion higher than the previous decade (2000-2009). ...it is impossible to know precisely what the next decade will bring. If loss trends are a guide, however, then it is expected that there will continue to be larger and costlier events on a global scale.”<sup>7</sup> While the world's attention is rightly focused on addressing the Covid-19 pandemic, the potential widespread humanitarian, economic and environmental costs of climate-change and climate-related shocks cannot be under-estimated and need to be mitigated and adapted for immediately, not left to some future date.
- **Trade and financial fragility:** Added to these examples, are growing trade tensions and ongoing global financial fragility. Even before the onset of the Covid-19 pandemic, rising geopolitical tensions were reverberating across the world economy. Merchandise trade among G20 economies contracted by 1.6% in the second quarter of 2019 and continued its downward path through the remainder of the year.<sup>8</sup> Foreign direct investment has followed a similar trajectory, reflecting growing uncertainty about changes in national policies and the effectiveness of enforcement of international commitments as a result of these political tensions.

There is no doubt that such risks are on the rise. In 2019 and 2018, four of the five top-rated risks in the World Economic Forum's *Global Risks Report*, which identifies the highest rated risks in terms of impact and likelihood based on surveys of leaders in business, government and civil society, were related to environmental or societal issues. They included extreme weather events, water crises, natural disasters, and failure of climate change mitigation and adaptation. In 2008, only one societal risk, pandemics, was reported in the top five risks in terms of impact.

## 2. The growing materiality of ESG&D stewardship risks and opportunities

The trends outlined above are increasing the *materiality* of ESG&D issues for corporations in almost every industry sector. What does this mean in practice? While the specifics may differ depending on industry and circumstances, ESG&D risks and opportunities have rising potential to affect the financial condition or operating performance of companies. This is due to the fact that they have a growing impact on a company's ability to create and sustain economic value, effectively manage risks or preserve value, and meet societal expectations. These fundamental changes in the factors underpinning value creation, risk management and societal expectations are requiring Boards to think beyond the traditional segmented logic of shareholder primacy and corporate responsibility.

“**Fundamental changes in the factors underpinning value creation, risk management and societal expectations are requiring Boards to think beyond the traditional segmented logic of shareholder primacy and corporate responsibility.**”

### **Creating and sustaining economic value**

Healthy profits remain a *sine qua non*. Yet, in this new context, issues that were previously considered a secondary or even ancillary matter for CEOs and Boards – the province of the firm's stakeholder relations, philanthropy and information technology departments – have become important determinants of a firm's capacity to create and sustain economic value. They therefore deserve to be part of the core strategic, risk management, performance evaluation and public reporting duties of Boards.

Climate change, water management and other aspects of environmental stewardship, for example, are increasingly material economic factors in a world in which related technology, regulation and physical impacts are changing within the space of years and sometimes months. The same is true for the management of the key source of competitive advantage in the Fourth Industrial Revolution: intangible assets. The development of the talent and motivation of a firm's workforce as well as its stewardship of other intangible assets, including technology, process know-how and data, are also increasingly important drivers of value creation.

Company strategy with respect to the planet, people and innovation (including the protection and value-added application of its data) therefore must figure more prominently in capital allocation decisions going forward. This implies a growing need to better understand and address the trade-offs between investment in new capacity and capabilities and the rationalization of existing operations and assets, with the intention to place greater emphasis on the former over time. Doing a better job of investing for future growth while still delivering current operational efficiency and excellence implies longer investment time horizons extending beyond the depreciation schedules of capital equipment and

typical return-on-investment timelines of efficiency-enhancing strategies such as cost-cutting, restructuring or outsourcing. Such strategies will clearly remain important elements in the ability of companies to create value, but for the firm's success to be sustained over time and shared with key stakeholders, Boards and executive teams need to pay particular attention in the Fourth Industrial Revolution to ensuring that capital is properly allocated to longer-term investments in new products, skills and productive capacity.

### **Managing risks and preserving value**

Effective stewardship of the firm's environmental, social, governance and digital footprint is also increasingly important for *value preservation*. It therefore must figure more prominently in enterprise and operational risk management as well.

An important part of the risk these factors pose is reputational. As such, they are just as crucial to the maintenance of trust as traditional governance issues such as ethics, transparency and Board independence. The immediate and long-term reputation damage resulting from a customer data breach, environmental disaster, corruption scandal or human rights abuse can be substantial.

In many cases, however, reputation damage is only part of the costs that a company will incur. Failure to effectively manage ESG&D risks can result in a combination of safety risks, other physical and supply chain risks, litigation and regulatory risks, and risks not only to external reputation, but also to employee morale and the ability to attract and retain the best talent. Systemic risks, in particular technological disruption and climate change, can also result in serious transition risk for companies in certain industries and threaten their long-term viability as a business if they are not able to manage the risks and adapt with new products, services and business models.

This new materiality of ESG&D factors to *value creation* and *value preservation* creates an imperative for them to be integrated fully into the theory and practice of corporate governance, including the Board's oversight of capital allocation, risk management, reporting and performance evaluation and remuneration. In the new environmental, social, geopolitical and technological context of the 2020s, these factors are not only ethical or constituent relations matters. They are integral to the exercise of fiduciary duty in the disposition of corporate resources.

### **Addressing societal expectations**

The growing materiality of ESG&D issues and the related business case for integrated governance is not solely an economic one. Societal expectations of corporations are also changing, as popular concern about automation, trade, climate change, inequality, corporate ownership of personal data, corruption and other issues rises. These broader trends, compounded by the legacy of the financial crisis, have produced a deficit of trust in corporations in many countries,<sup>9</sup> as well as growing debate about whether they contribute sufficiently to the ultimate purpose of economies, which is to produce the broad-based gains in living standards that come from inclusive economic growth.<sup>10</sup>

These social pressures are likely to mount further as technology continues to increase economies of scale, disrupt industries and, other things being equal, shift the distribution of national income in the direction of owners of capital and away from labour. The OECD reports that there has been a significant such shift in the past two decades within advanced economies, although with considerable variation between countries, industries and skill cohorts of workers.<sup>11</sup> This distributional shift and hollowing out of the middle class in many countries has been driven by not only technological change but also public policy and corporate strategy choices, and it is contributing to the drop in public support for open markets and to the polarization of politics more generally in some countries.

In this new context, Boards of Directors have a heightened fiduciary responsibility for both economic and social reasons to ensure that their firms are creating sustainable shared value and not just maximizing short-term profit through cost efficiencies and rent extraction, and to ensure that they are properly addressing new risks that have grown out of the changed technological, environmental, geopolitical and social context of their operations. Moreover, they need to recognize that the long-term viability of their companies as engines of value creation is in no small part a function of the viability of the societies and economies in which they operate. In other words, companies *are stakeholders themselves* in the health of their social, policy and economic enabling environment. In particular, they have an intrinsic, material stake in both the social cohesion of the jurisdictions in which they have significant operations and the capacity of public institutions therein to deliver basic public services and ensure the fair and efficient functioning of markets.

“Companies are stakeholders themselves ... in both the social cohesion of the jurisdictions in which they have significant operations and the capacity of public institutions therein to deliver basic public services and ensure the fair and efficient functioning of markets.”

In summary, ESG&D risks and opportunities are becoming more material for many companies across all industry sectors in terms of their ability to create and sustain value, manage risks and preserve value, and address changing societal expectations. Failure to effectively understand and manage them increasingly poses, at best, lost business opportunities. At worst, it poses risks to a company's financial and operational performance, its reputation and relationships with key stakeholders from investors and regulators to employees and customers, and in certain cases its long-term viability.

### **The costs of failing to act – and to govern**

Some companies and industry sectors are already learning the hard way that failure to treat their material ESG&D issues as important corporate governance considerations can result in the rapid deterioration of investor, employee and societal trust and substantial impairment of value.

Consider the challenge of avoiding and responding to **breaches in data privacy**, for example. The *2019 Cost of a Data Breach Report*, sponsored by IBM Security, estimates that the immediate and ongoing cost of a data breach has risen by 12% over the course of five years, and organizations can expect to pay an average of \$3.92 million.<sup>12</sup> The impact for smaller companies can be devastating. For large corporations in sectors such as healthcare, financial services and retail, with responsibility for the data of millions of people, the financial and reputational costs are substantial, with the costs of responding to and resolving the problem and ongoing lawsuits and regulatory fines reaching hundreds of millions of dollars. In 2018, for example, in the United States more than 2.8 billion consumer data records were exposed in 342 breaches, at an estimated cost of \$654 billion.<sup>13</sup>

“Companies are facing substantial financial and operational risks as a result of failing to address the impact of climate change on their business.”

Likewise, companies are facing substantial operational, financial and transitional risks as a result of failing to address the **impact of climate change** on their business. These are proving to be significant short-term costs as well as long-term profitability and even viability risks for many companies, especially but not only for those in the insurance, utility and energy sectors. A recent study by Ceres, for example, cited the following climate-related corporate risk statistics:<sup>14</sup>

- *Physical risks*: In 2017, 73 companies on the S&P 500 publicly disclosed a material effect on earnings from weather events and over 90% of these companies disclosed the effect on earnings was negative.
- *Supply chain risks*: Supply chain disruptions due to climate risk increased 29% from 2012 to 2019.
- *Litigation risks*: More than 100 cases have been filed in the US on climate change impacts as of May 2019.
- *Regulatory risks*: The number of climate change regulations has grown to 1,500 globally, up from 72 in 1997.

The **#MeToo Movement** offers another example of the growing financial, reputational and operational costs being faced by companies that have failed to strategically address issues of workplace discrimination, sexual harassment or misconduct. As *Fortune* magazine has noted, based on the Conference Board's 2019 edition of the *CEO Succession Practices* report, “Among the 18 nonvoluntary CEO departures, 5 oustings were related to personal conduct and #MeToo allegations. That's especially noteworthy given that only one CEO between 2013 and 2017 was fired as a result of personal conduct unrelated to performance, according to the Conference Board. Overall, the trend is proof that the #MeToo movement has reached the boardroom.”<sup>15</sup> This is just the tip of the iceberg in terms of the costs to employee morale and trust, litigation, shareholder derivative lawsuits and reputational harm that companies are facing as a result of a long-standing set of human rights, inclusion and diversity issues that had not been given the prominence and importance they deserved at the Board level.

These brief examples of the growing materiality to companies and their Boards of data stewardship, climate risk management, mitigation and adaptation, and respecting human rights are just three key examples of the need for greater Board oversight of ESG&D issues. More broadly, research by Bank of America Merrill Lynch released in September 2019 found that, “15 out of 17 (90%) bankruptcies in the S&P 500 between 2005 and 2015 were of companies with poor Environmental and Social scores five years prior to the bankruptcies”, and “major ESG-related controversies during the past six years were accompanied by peak-to-trough market capitalization losses of \$534 billion for large US companies. Loss avoidance is key for portfolio returns over time.”<sup>16</sup>

An analysis of US proxy voting trends on environmental and social issues from 2000 to 2018 further illustrates the point of growing materiality. As a commentary by the Managing Editor of ISS Analytics states:

...the reality is that investor voting behavior among owners of U.S. companies has changed significantly – perhaps almost revolutionarily – over the past two decades. ... Proxy voting policies are becoming more complex, as investors continue to add to the list of factors they consider in their review and analysis of governance practices, including board independence, board accountability, diversity, myriads of executive compensation factors, shareholder rights, and environmental and social factors. Based on our analysis, the most significant change in investors’ voting behavior pertains to environmental and social issues, as these issues are earning record levels of support in recent years.<sup>17</sup>

The Bank of America Merrill Lynch and ISS research are just two of a growing number of studies from the financial, consulting and academic communities to make the case for the growing materiality of ESG&D issues and for integrating them into corporate governance. The specific issues and the materiality of the risks and opportunities that they present to a company will vary based on industry sector, geography and circumstances. But no large company or its Board is immune to this trend. The Sustainability Accounting Standards Board (SASB) has worked through an extensive consultation process with major corporations and investors to identify the most material ESG issues for 77 industry sectors.

As the following sections outline, change has already been under way over the past two decades. The challenge now is to take it to the next stage of integration among leading companies and of expansion across the business community more broadly.

**“ ...the growing materiality to companies and their Boards of data stewardship, climate risk management, mitigation and adaptation, and respecting human rights are three key examples of the need for greater Board oversight of ESG&D issues. ”**

### 3. The evolution of corporate governance and corporate responsibility

#### Corporate governance

The paradigm of shareholder value maximization as the core fiduciary responsibility of Boards of Directors gained prominence in the United States during the 1970s. It was influenced by Milton Friedman's *New York Times Magazine* article of 1970, denouncing corporate social responsibility, and the seminal 1976 *Journal of Financial Economics* article "Theory of the firm", by Jensen and Meckling.<sup>18</sup> It was supported by business leaders and organizations such as the Business Roundtable (BRT), which issued its first *Principles of Corporate Governance* in 1978. From its origins in the United States, shareholder primacy has driven the principles and practice of corporate governance and the legal interpretation of fiduciary responsibility in a growing number of other economies, gaining additional traction in the late 1980s and 90s during the era of large-scale economic liberalization, globalization and privatization.

Different ownership and corporate governance models in a number of European countries have tempered the spread of shareholder primacy, such as two-tier boards with an explicit governance role for labor and foundation ownership structures. Likewise, in a variety of jurisdictions, such as the UK, Australia, India and South Africa, the legal concept that Directors owe their duty to the Company rather than to the Shareholders has become more clearly articulated as a result of seminal reviews and revisions to corporate governance codes. The OECD's Principles of Corporate Governance, first published in 1999 and most recently revised in 2015, now provide guidance on responsibilities to both shareholders and other stakeholders and are increasingly used as an international benchmark including by the G20, Financial Stability Board and World Bank.

“Today, the paradigm of shareholder value maximization is shifting in most countries.”

Today, the paradigm of shareholder value maximization is shifting in most countries. This shift is being driven by a combination of lessons learned over several decades of corporate scandals, the global financial crisis and the growing materiality of ESG&D factors. The ability to be profitable and deliver measurable value for shareholders in the short term remains essential and is a particularly strong focus of influential activist investors. At the same time, a combination of leading CEOs, investors, regulators, activists and academics are calling for companies to make an explicit and measurable commitment to harmonize the needs of all key stakeholders, including but not only shareholders, and to demonstrate their strategies for delivering long-term as well as short-term value.

In 2017, an article by Joseph Bower and Lynn Paine in *Harvard Business Review*, made the compelling assertion, "Most CEOs and Boards believe their main duty is to maximize shareholder value. It's Not."<sup>19</sup> The authors make a strong case for moving to a "company centered" versus "shareholder centered" approach to corporate governance, with guidance on the changing role of Boards, including setting the business purpose of their company. Research by a growing number of other management, governance and legal academics reinforces these ideas of a broader corporate purpose than maximizing shareholder value and a changed role for Boards of Directors as a result.

Many of the world's largest asset owners and managers are also increasing their focus on long-term value creation and ESG stewardship as part of their analysis of and engagement with major corporations. The evolution over the past few years of the annual corporate governance letter sent to CEOs by BlackRock's Larry Fink is one example, which explicitly calls on CEOs and Boards to take responsibility for focusing on strategy aligned to long-term value creation, for understanding and ensuring oversight of the company's purpose and role in society, and for assessing and reporting on climate-related financial risks.

In 2019, Martin Lipton of the law firm Wachtell, Lipton, Rosen & Katz issued a commentary entitled, "It's Time to Adopt the New Paradigm". Based on a 2016 paper prepared for the Forum, he outlines, "...a reconception of corporate governance as a collaboration among shareholders, managers, employees, customers, suppliers, and the communities in which corporations operate".<sup>20</sup> Their law firm is not alone. In recent years, the American, European and International Bar Associations, among others, have provided guidance to companies and their Boards on the legal implications of respecting human rights and addressing other ESG&D issues.

And, in August 2019, 181 CEO members of the BRT signed a new *Statement on the Purpose of a Corporation*, committing to leading their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders. As the BRT comments, "Each version of the document issued since 1997 has endorsed principles of shareholder primacy – that corporations exist primarily to serve shareholders. With today's announcement, the new Statement supersedes previous statements and outlines a modern standard for corporate responsibility."<sup>21</sup> In making this statement, the BRT, among other business organizations, is committing to much clearer alignment between the concepts and the practices of corporate governance and corporate responsibility.

## **Corporate responsibility and citizenship**

The related fields of corporate responsibility and corporate citizenship have also evolved substantially over the past two decades – and in a similar direction. During this period, they have transformed from being focused almost solely on philanthropy and basic compliance with the law to now focusing primarily on:

1. How companies identify and manage the ESG risks and opportunities that are most material to their core business strategies, operations and performance and that are most salient to people and the planet;
2. How companies measure, report and account for their performance in relation to these material and salient ESG risks and opportunities to key stakeholders, including but not only shareholders.

In 1999, at the World Economic Forum Annual Meeting in Davos-Klosters, the late UN Secretary-General Kofi Annan called on business leaders, "...individually through your firms, and collectively through your business associations – to embrace, support and enact a set of core values in the areas of human rights, labour standards, and environmental practices."<sup>22</sup> This led to the creation of the UN Global Compact, today the world's largest voluntary initiative based on CEO commitments to uphold a set of 10 universal principles in the above areas and anti-corruption.

In 2002, a task force of CEOs from the World Economic Forum in partnership with the Prince of Wales International Business Leaders Forum developed a framework for *Global Corporate Citizenship*, in which the CEOs stated:

First and foremost, our companies' commitment to being global corporate citizens is about the way we run our own businesses. The greatest contribution we can make to development is to do business in a manner that obeys the law, produces safe and cost effective products and services, creates jobs and wealth, supports training and technology cooperation and reflects international standards and values in areas such as the environment, ethics, labour and human rights. To make every effort to enhance the positive multipliers of our activities and to minimize any negative impacts on people and the environment, everywhere we invest and operate. A key element of this is recognizing that the frameworks we adopt for being a responsible business must move beyond philanthropy and be integrated into core business strategy and practice. Second, our relationships with key stakeholders are fundamental to our success inside and outside our companies ... in the workplace, in the marketplace, along our supply chains, at the community level and in public policy dialogue.<sup>23</sup>

Building on the 2002 statement, in 2008 another task force of CEOs working with the Forum, Business for Social Responsibility (BSR), Harvard Kennedy School, AccountAbility and the International Business Leaders Forum focused on the role of business in working collectively beyond their own operations and supply chains to help strengthen *public governance*. This group outlined specific actions that companies could take as good corporate citizens to strengthen the broader enabling environment in which business operates. Examples ranged from joint efforts to help governments build capacity and deliver public goods such as health, education and training, to tackling corruption at the national level, as well as bringing a business voice to global governance frameworks. The report was one of the first of its kind that outlined a clear roadmap for building mutually reinforcing links between corporate responsibility and citizenship, corporate governance and public governance.<sup>24</sup>

Also in 2008, in a seminal article in *Foreign Affairs* magazine, Forum Founder and Managing Director Klaus Schwab wrote:

... a new imperative for business, best described as "global corporate citizenship," must be recognized. It expresses the conviction that companies not only must be engaged with their stakeholders but are themselves stakeholders alongside governments and civil society. International business leaders must fully commit to sustainable development and address paramount global challenges, including climate change, the provision of public health care, energy conservation, and the management of resources, particularly water. Because these global issues increasingly impact business, not to engage with them can hurt the bottom line. Because global citizenship is in a corporation's enlightened self-interest, it is sustainable.<sup>25</sup>

In 2011, further impetus came from work by Michael Porter and Mark Kramer, who coined the term "Creating Shared Value" to describe how companies can create both economic and social value by reconceiving products and services, redefining productivity in the value chain and improving their operating environment.<sup>26</sup> In the same year, the UN Guiding Principles on Business and Human Rights, authored by John Ruggie, were unanimously endorsed by the UN Human Rights Council. And, in the lead up to 2015, a core group of business leaders from diverse countries and industry sectors played a role in the consultations and negotiations that resulted in the Paris Agreement on climate change and the Sustainable Development Goals (SDGs).

In recent years, such voluntary leadership and commitments by a small number of CEOs and Boards have grown substantially in terms of the number and impact of companies taking an approach to corporate responsibility and citizenship that is focused on identifying and managing the material ESG&D-related risks and opportunities in their core business operations and business relationships. A key driver has been the growing focus on ESG&D issues by many of the world's largest asset owners and managers, from sovereign wealth funds, pension funds and insurance companies to other institutional investors. The signatories of the UN Principles for Responsible Investment, for example, have grown from 100 in 2006 to over 2,300 in 2019, and together account for more than \$70 trillion in assets under management.<sup>27</sup>

Today, the focus by many large companies on integrating material ESG&D risks and opportunities into core business strategy, operations, supply chains and policy dialogue is more important and relevant than ever. And, more than ever, it calls for Board-level engagement and oversight.

A lack of clarity and commonality remain on terminology and metrics remains a challenge for many companies investors and other stakeholders. These practices are variously described as corporate responsibility, corporate citizenship, corporate social responsibility, corporate sustainability, triple bottom line, creating shared value, inclusive business models, total societal impact and ESG, to name some of the more common terms used. Linked to different terminology and approaches, a plethora of measurement and ranking systems are being used by companies, investors and other stakeholders to evaluate and compare business commitments and performance on ESG&D issues. Yet, in all cases, the attention of leading companies, shareholders and other stakeholders is increasingly focused on the issues that are most material to the company and salient to people and the environment.

**“ Today, the focus by many large companies on integrating material ESG&D risks and opportunities into core business strategy, operations, supply chains and policy dialogue is more important and relevant than ever. And, more than ever, it calls for Board-level engagement and oversight. ”**



## Towards stakeholder capitalism and integrated corporate governance

In principle, profound changes in the operating context of companies are aligning the interests of shareholders and other stakeholders more closely. The heightened financial materiality of ESG&D factors has the potential to usher in a new phase of capitalism – stakeholder capitalism – which shifts market economies beyond the managerial capitalism of the 1950s to 1970s and the financial capitalism of the 1980s to 2010s, a hallmark of which has been the pre-eminence of shareholder value and the segmentation and *de facto* subordination of environmental, social and broader value chain stewardship issues.

Stakeholder capitalism holds great promise for both shareholders and society at large. By better internalizing factors that influence value over time, it could generate stronger and more resilient financial returns for the ultimate owners of companies: people with retirement and other saving accounts intended to fund medium- to long-term family needs. At the same time, it could accelerate progress towards the larger aspirations of society, such as combating climate change, reducing inequality and advancing sustainable development more broadly through the attainment of the SDGs.

As outlined earlier, the principles of stakeholder capitalism have recently been restated in the Forum’s refreshment and republication of its 1973 corporate governance manifesto and the BRT’s statement of corporate purpose, as well as in national regulations and frameworks, such as the revised UK Corporate Governance Code and the UK Stewardship Code 2020, among others. But realizing the shared value potential articulated by these principles will require companies to translate them into practice, and nowhere more so than in boardrooms. In particular, Boards must transcend the traditional segmentation of shareholder and stakeholder considerations – exemplified by the concepts of shareholder primacy and corporate responsibility – by *integrating* them.

*Integrated corporate governance* departs from the mindset and associated practices of shareholder primacy and corporate responsibility, which have regarded ESG&D factors as primarily non- or pre-financial matters. Instead, it takes a holistic view of shareholder and wider stakeholder interests by systematically *internalizing* ESG&D considerations into the firm’s strategy, resource allocation, risk management and performance evaluation and reporting policies and processes. It does so not for ethical or political reasons, although these are crucial factors that must also be addressed by Boards, but out of a recognition that shareholder value creation beyond the near term is increasingly dependent in the 21st century upon a rigorous understanding and active management and governance oversight of these risks and opportunities.

If stakeholder capitalism is to be more than an optimistic vision, it will require this integration and internalization to become better defined in operational terms and such practices adopted in widespread fashion by Boards. Section II provides an overview of emerging good practices and remaining open issues for companies and their Boards in six critical areas.

“ Integrated corporate governance departs from the mindset and associated practices of shareholder primacy and corporate responsibility, which have regarded ESG&D factors as primarily non- or pre-financial matters. Instead, it takes a holistic view of shareholder and wider stakeholder interests by systematically internalizing ESG&D considerations into the firm’s strategy, resource allocation, risk management and performance evaluation and reporting policies and processes. It does so not for ethical or political reasons, although these are crucial factors that must also be addressed by Boards, but out of a recognition that business value creation beyond the near term is increasingly dependent in the 21st century upon a rigorous understanding and active management and governance oversight of these risks and opportunities. ”

“ If stakeholder capitalism is to be more than an optimistic vision, it will require this integration and internalization to become better defined in operational terms and such practices adopted in widespread fashion by Boards. ”

## II. A Board leadership agenda for integrated corporate governance

The previous section argued that changes in the nature of value creation, risk and societal expectations require a new, more integrated approach to corporate governance that transcends the traditional, segmented approach to managing financial returns and ESG&D considerations.

“**In the Fourth Industrial Revolution, good corporate governance ... requires a heightened level of stewardship by Boards in six areas.**”

In sum, in the Fourth Industrial Revolution, good corporate governance – that is, the sustained generation of economic value and the maintenance of stakeholder and societal trust – requires a heightened level of stewardship by Boards in six areas:

1. Align strategy and capital allocation with drivers of long-term value creation
2. Internalize material ESG&D factors in enterprise risk management
3. Strengthen preparedness and resilience to crises and systemic shocks
4. Engage the firm in cooperative efforts to strengthen its operating environment
5. Prepare the company’s mainstream reporting in an integrated manner
6. Adapt the Board’s organization, composition and engagement to these imperatives

An action agenda for Boards wishing to travel this journey follows. It references existing practical frameworks and public-private initiatives that are ready to be applied for this purpose.

“**The Fourth Industrial Revolution is transforming value creation in many industries, including by placing greater emphasis on intangible capital formation.**”

### 1. Align strategy and capital allocation with drivers of long-term value creation

Boards must provide support and guidance to management on aligning their strategic and particularly capital allocation priorities with drivers of long-term value creation. As companies adapt to a new economic context, changed workplace conditions and raised expectations following the Covid-19 pandemic, alongside ongoing environmental constraints and acceleration toward digital transformation and the [Fourth Industrial Revolution](#), they must intensify their focus on intangible drivers of value. These include research and innovation, respect for human rights, employee wellbeing, talent development, corporate culture, and strengthening external stakeholder relationships and public trust. Capital allocation priorities need to be rigorously challenged to balance near-term returns and distributions to shareholders with investments in long-term competitiveness and growth opportunities, supply chain resilience and human, social and natural capital and infrastructure.

What is long-termism? An April 2020 report, [Tone at the Top: The Board’s Impact on Long-Term Value](#) by Russell Reynolds Associates and [Focusing Capital on the Long Term](#) (FCLTGlobal) provides a useful summary:

It is how boards and executives think and act in regard to the practice of applying a long-term approach to business and investment decision-making, including focusing on key elements of performance such as competitive advantage, long-term objectives and a strategic plan matched with clear capital allocation priorities. It stands in contrast to short-termism, or a continued focus on quarterly or other near-term performance issues, and is increasingly in demand from stakeholders who want a fundamental rethink around how companies operate and create value.

Consensus among leading investors and companies on the need for a greater Board focus on long-termism has been gathering momentum for several decades, especially since the Global Financial Crisis. Collective initiatives such as [Focusing Capital on the Long Term](#), [The Embankment Project for Inclusive Capitalism](#), and the [Aspen Institute’s Business and Society programme on Long-Term Capital](#), among others, are developing important insights, tools and metrics to support Boards and executive teams in driving long-term investment.

The World Economic Forum is doing likewise. In 2017, the Forum’s International Business Council (IBC) created [The Compact for Responsive and Responsible Leadership: A Roadmap for Sustainable Long-Term Growth and Opportunity](#). Signed by 145 major companies from 35 countries, the Compact commits firms to acting to:

- Ensure the Board oversees the definition and implementation of corporate strategies that pursue sustainable long-term value creation.
- Encourage the periodic review of corporate governance, long-term objectives and strategies at the Board level as well as clear communication between corporations, investors and other stakeholders about the outcomes.
- Promote meaningful engagement between the Board, investors and other stakeholders that builds mutual trust and effective stewardship, and promotes the highest possible standards of corporate conduct.
- Publicly support the adoption of the Compact and implement policies and practices within the organization that drive transformation towards adherence to long-term strategies and sustainable growth for the benefit of all stakeholders.

The overall aim of the Compact is to provide guidance for governance and investor relations practices to balance short- and long-term business practices. [The Forum's Platform for Shaping the Future of Investing](#) supports the effort and is building a related community and body of work on Active Investor Stewardship, with the goal of building a set of tools for stronger and more long-term-focused investor-corporate relationships.

Work by these and other initiatives continues to focus on two important enablers of long-termism. First, is a growing body of research and evidence to support the business case for Boards to engage proactively with management on maintaining a long-term commitment and approach to capital allocation even while executing on shorter-term imperatives. Second, is collective efforts that are combining survey work, legal analysis and accounting methodologies to develop common metrics and reporting practices for long-term oriented Boards and investors.

For example, in 2017, research by the McKinsey Global Institute in cooperation with FCLTGlobal found compelling evidence that companies deliver superior results when executives manage for long-term value creation and resist pressures to focus excessively on meeting quarterly earnings expectations. Using a dataset of 615 large- and mid-cap U.S. publicly listed companies from 2001 to 2015, they created a five-factor [Corporate Horizon Index \(CHI\)](#) based on investment, earnings quality, margin growth, quarterly management and earnings-per-share growth. After controlling for industry characteristics and company size, their findings showed that companies classified as “long term” outperformed their shorter term peers on a range of key economic and financial metrics. In particular, they concluded that over the 14-year period, long-term firms:

- Exhibited stronger fundamentals and delivered superior financial performance;
- Continued to invest in sources of growth, for example R&D, even in difficult times; and
- Added more to economic output and growth, including job creation.

Alongside ongoing research on the business benefits and broader economic impact of long-termism, is a growing momentum around developing appropriate performance metrics and reporting practices for long-term oriented Boards. For example, to-date accounting and reporting have not fully addressed the challenge of measuring and reporting the value of intangible assets. As a result, there is still a significant discrepancy between market capitalization and reported assets (around 2:1). This means that around 50% of the market capitalization is effectively unaccounted for, creating a skewed view of an organization's ability to create long-term value. A central aspect of a firm's intangible capital is the talent of its people, and this has long been an area of underinvestment by companies as well as governments. As outlined further in this paper, other aspects of ESG&D performance are also key components of a firm's non-financial and intangible capital, and need to be more rigorously measured and accounted for, with Board oversight.

In their 2019 report, [Predicting Long-term Success for Corporations and Investors Worldwide](#), FCLTGlobal reviewed long-term performance in terms of Return on Invested Capital (ROIC), focusing on the large publicly traded companies in the MSCI All Country World Index (AWCI), which represents 85 percent of the global investable opportunity set. They concluded that using Total Shareholder Return (TSR) rather than ROIC would have produced similar, if slightly weaker, results. Their analysis identified the following range of factors associated with the long-term health of companies:

- Factors associated with higher long-term value creation: Greater fixed investment; higher research quotient (RQ); greater board gender diversity; higher sales growth; and greater long-term investor presence.
- Factors associated with lower long-term value creation: Overdistribution of capital; ESG controversies; providing short-term guidance; and leverage ratio.

There is obviously no simple ‘one-size-fits-all’ approach and appropriate capital allocation will vary depending on factors such as industry, strategy, risk tolerance and growth profile. While the specifics may vary, however, all Boards should be engaging management in rigorous dialogue and analysis on how best to achieve long-term value creation while delivering short-term performance. Leading Boards, for example, are reviewing performance targets and capital allocation plans through both a long and short-term lens as well as aligning director and executive compensation more closely to long-term success and investing more time in reviewing corporate culture and talent development beyond the executive team. They are allocating more dedicated time to strategy discussions and retreats. And, as part of this process they are engaging with and learning from external perspectives to better understand long-term risks, disrupters and opportunities, not only key institutional investors but also other stakeholders.

## 2. Internalize material ESG&D factors in enterprise risk management

The Fourth Industrial Revolution and Globalization 4.0 are accentuating several risks that henceforth will require more explicit and proactive attention by Boards. The loss of trust stemming from problems in any of them can reverse years of advances in market value and threaten a firm's very existence, especially if accompanied by high litigation and remediation costs and/or fines and increased regulatory oversight. These include risks relating to the security of personal and other sensitive data; the deployment of algorithms in internal processes and external products and services; climate change; corruption and financial crime; and human rights and labour practices.

In 2018, in its report *Enterprise Risk Management*, the World Business Council for Sustainable Development cooperated with the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to release guidance for applying enterprise risk management to ESG-related risks.<sup>28</sup> In 2019, Ceres also published guidance on how corporate Boards can oversee ESG risks in the report entitled *Running the Risk*.<sup>29</sup> In addition to broad frameworks, there is a growing need for more topic-specific and technically rigorous guidance for Boards focused on those ESG&D issues that represent the most material risks and opportunities to business. Following are some good practice governance principles and tools that have been created for use by companies on key ESG&D topics. Boards wishing to internalize these ESG&D factors into their firm's efforts to create and preserve value through diligent risk management should ensure that their firms apply these frameworks and management systems or their equivalent.

### A. Environmental

The Financial Stability Board's Industry Task Force on Climate-related Financial Disclosures (TCFD) recently established a corporate governance framework in respect of climate change that has begun to be adopted by companies and investors around the world. The Climate Disclosure Standards Board (CDSB) and Sustainability Accounting Standards Board (SASB) have produced a joint TCFD [Implementation Guide](#)<sup>30</sup> and related set of [Good Practices](#)<sup>31</sup> for the reporting of climate-related performance and risk in mainstream corporate reports in line with the TCFD framework. And in 2019, the Forum issued a set of climate governance [principles for Boards of Directors](#). Developed in collaboration with PwC, these are designed to help increase directors' climate awareness, embed climate issues into Board structures and processes and improve navigation of the risks and opportunities that climate change poses to business.<sup>32</sup> By providing a compass to enable more effective climate governance within companies, this framework provides Boards with the right tools to make the best possible decisions for the long-term resilience of their organizations.

“ Best practice in this respect is to set and disclose annual progress towards a GHG reduction target. This is a step all organizations can take. ”

Best practice in this respect is to set and disclose annual progress towards a GHG reduction target. This is a step all organizations can take to increase both their internal operating efficiency and the pace at which society is implementing the goals set by the United Nations Paris Agreement.<sup>33</sup> To that end, the Forum is encouraging its Partners and Members to commit<sup>34</sup> to aligning their GHG emission reduction targets with the 1.5°C emissions scenario recommended by the scientists of the Intergovernmental Panel on Climate Change to achieve net-zero emissions by 2050.

The increasingly urgent need for Boards to understand and improve the management and governance of climate-related risks and opportunities has been the key driver in ensuring that environmental issues have become a boardroom topic across industry sectors. Depending on the industry sector, Boards also need to be asking the same types of questions around their company's policies, strategies, risk management processes and targets for tackling other material environmental issues, such as water insecurity, biodiversity loss and pollution.

### B. Social

Effectively addressing the “S” in ESG&D requires a company to respect human rights and to address the most salient risks that its operations and business relationships pose to people and their right to be treated with dignity. The United Nations Guiding Principles on Business and Human Rights (UNGPs) are the authoritative global standard on business and human rights. The UNGPs clearly state that “all companies everywhere have a responsibility to respect human rights, which means to avoid having negative impacts on them and to address such impacts where they do occur. This responsibility applies to their own operations and to all their business relationships, including those throughout their value chain.”<sup>35</sup>

Boards should have oversight on what human rights policies, due-diligence processes, stakeholder engagement and remediation mechanisms their company has in place to respect human rights. They should also understand the human rights risks that are not only material to the company, in terms of its own legal, financial, operational and reputational risks, but also salient to people affected by the company's operation and business relationships. The UK's Equality and Human Rights Commission has prepared *Business and human rights: A five-step guide for company boards*, which provides useful guidance for Boards on implementing the UNGPs.

In addition to the UNGPs, a variety of industry-sector initiatives focus on defining standards that companies in that sector should adhere to in respecting human rights, especially in high-risk areas such as oil, gas and mining, agriculture, apparel and other consumer goods manufacturing, tourism, financial services and information and communications technology.

Extensive guidance also exists on specific issues, such as labour practices, employee health and safety, tackling discrimination and harassment and improving inclusion and diversity, community relations, indigenous peoples' rights, consumer and product safety, etc. Boards in every industry sector should be aware of such initiatives and understand if and how their company is adhering to industry-wide or issue-specific standards.

Examples of three long-standing examples of a collective sector and issue-focused approach to addressing human rights in global supply chains are:

- **The Fair Labor Association (FLA):** This alliance of companies, universities and non-governmental organizations was established in 1999 to implement a Workplace Code of Conduct in the apparel sector that defines labour standards that aim to achieve decent and humane working conditions. The Code's standards are based on [International Labour Organization standards](#) and internationally accepted good labour practices. Companies affiliated with the FLA are expected to comply with all relevant and applicable laws and regulations of the country in which workers are employed and to implement the Workplace Code in their applicable facilities. When differences or conflicts in standards arise, affiliated companies are expected to apply the highest standard.
- **The Ethical Trading Initiative:** This initiative was established in 1998 and is working with an alliance of retail and brand companies and their suppliers, trade unions and development organizations to improve the working conditions of the people who make the products they sell in thousands of factories and farms in developing countries.
- **The Voluntary Principles on Security and Human Rights:** Established in 2000, this alliance is comprised of governments, oil, gas and mining companies and non-governmental organizations. It focuses on guiding companies to conduct their security operations while respecting human rights.

The increasingly strong focus on promoting greater inclusion and diversity within companies, their value chains and communities is another important aspect of social and human capital oversight that needs to be systematically addressed by Boards. Preventing discrimination and harassment based on race, religion, nationality, gender, sexual orientation, disability, age and other personal traits and characteristics is a key component of respecting human rights. In addition there is a growing imperative for Boards to be more proactive in addressing ways in which their company's corporate culture, behaviours, social norms and incentives are either promoting or impeding more diverse and inclusive working environments, value chains and communities.

## C. Governance

Key governance issues over which Boards need to ensure strong oversight include the company's policies, standards, audit processes and performance in areas such as ethics compliance and integrity, anti-corruption, anti-competitive behaviour, and compliance with myriad laws and regulations in different countries.

An area of growing focus for the Boards of many global companies is how to ensure a more holistic and systemic approach to tackling corruption that includes but goes beyond compliance to build a corporate culture of ethics and integrity. Useful guidance for Boards is provided by the World Economic Forum [Partnering Against Corruption Initiative](#) (PACI), launched in 2004 in partnership with Transparency International and the Basel Institute on Governance. PACI serves as the principal CEO-led platform in the global anti-corruption arena, focused on public-private cooperation, responsible leadership and technological advances.

The PACI [Principles](#), which commit a company to zero tolerance of bribery and the implementation of a management system to drive this commitment through the company's operations, have approximately 90 signatories of major companies from different industry sectors and regions. They serve as a call to action for businesses around the world to eliminate corruption in all its forms and join collective action initiatives to increase public trust in business, deliver fair markets and level the playing field in this crucial respect. In 2020, PACI also endorsed an [Agenda for Business Integrity](#) aimed at supporting leading companies to achieve the following four pillars of leadership action, all of which have implications for Board oversight and guidance:

- Commit to ethics and integrity beyond compliance
- Strengthen corporate culture and incentives to drive continuous learning and improvement
- Leverage technologies to reduce the scope of corruption
- Support collective action to increase scale and impacts.

Another area of growing focus is the increase in requests from investors and other stakeholders for greater transparency and public disclosure on corporate lobbying activities and where relevant political contributions. Increasingly, this includes requests for information on the company's financial and in-kind contributions to trade and industry associations, research institutions or coalitions and certain types of advocacy non-profit organizations. The Board increasingly needs to understand the nature and range of such relationships.

## D. Data stewardship

Over the past several years, it has become increasingly clear across a wide range of industry sectors that company data protection and use are far more than technical or operational matters. They are first order strategic considerations that pose major – potentially existential – risks as well as important opportunities for competitive advantage. Accordingly, Boards need to ensure that they have the skills and processes in place to perform these rapidly evolving dimensions of fiduciary responsibility diligently.

“Company data protection and use are far more than technical or operational matters. They are first order strategic considerations that pose major – potentially existential – risks as well as important opportunities for competitive advantage.”

### Cybersecurity

In 2017, the Forum issued a first-of-its-kind resource to support Boards of Directors and CEOs to take action on cybersecurity and cyber resilience: *Advancing Cyber Resilience: Principles and Tools for Boards*. Developed in collaboration with the Boston Consulting Group and Hewlett Packard Enterprise, the report is the product of an extensive process of collaboration and consultation that distilled leading practice into a framework and set of tools that Boards of Directors can use to smoothly integrate cyber risk and resilience into business strategy so that their companies can innovate and grow securely and sustainably.

The Forum has since released a second resource aimed at corporate leadership teams more broadly, entitled *The Cybersecurity Guide for Leaders in Today's Digital World*. Produced by the Forum's public-private Centre for Cybersecurity, the guide charts the key tenets of how cyber resilience in the digital age can be formed through effective leadership and design. From the steps necessary to think more like a business leader and develop better standards of cyber hygiene, through to the essential elements of crisis management, it offers a practical cybersecurity playbook for business leaders.

“Failing to design, develop and use AI responsibly can damage brand value, risk customer backlash and lead to litigation and financial costs.”

### Artificial intelligence (AI) and machine learning

As AI increasingly becomes an imperative for business models across industries, corporate leaders and Boards will be required to identify the specific benefits this complex technology can bring to their businesses as well as address concerns about the need to design, develop and deploy it responsibly. Striking the right balance will lead to sustainable businesses in the Fourth Industrial Revolution, but failing to design, develop and use AI responsibly can damage brand value, risk customer backlash and lead to litigation and financial costs. Board members of all companies are responsible for stewarding their companies through the current period of unprecedented technological change related to AI, and its attendant societal impacts.

A practical set of tools can empower Board members in asking the right questions, understanding the key trade-offs and meeting the needs of diverse stakeholders, as well as considering and optimizing approaches such as appointing a Chief Values Officer, Chief AI Officer or AI Ethics Advisory Board. The Forum has recently produced a Board toolkit, *Empowering AI Leadership*, which is being piloted by over a dozen firms. Developed by its Centre for the Fourth Industrial Revolution, this framework was established in consultation with over 100 stakeholders. It is designed to help Boards be responsible stewards of their companies' deployment of AI by more deeply understanding this transformational technology, asking the right questions, balancing trade-offs, meeting the needs of diverse stakeholders and formulating innovative governance approaches.

### Data collection, management and use

Business models in virtually every industry are becoming more data intensive. Companies are routinely accumulating and applying a large amount of personally and commercially sensitive data via their interaction with customers, suppliers, employees and others. Optimizing the collection, management and use of such data is an increasingly important value creation driver; however, it also poses new material risks that Boards cannot assume will be mitigated solely through compliance with regulatory requirements. A leading example of a company effort to formalize a stronger degree of data stewardship in order to maintain the trust of stakeholders and mitigate risk above and beyond regulatory compliance is Mastercard's recently issued [framework](#) of six principles for responsible data management. Its survey research suggests that an organization committing to these principles would help drive trust with upwards of 90% of individuals.<sup>36</sup>

“Optimizing the collection, management and use of such data ... also poses new material risks that Boards cannot assume will be mitigated solely through compliance with regulatory requirements.”

### 3. Strengthen preparedness and resilience to crises and systemic shocks

As outlined above, Boards need to understand and provide oversight on enterprise-level or specific operational, financial, reputational and regulatory risks that a company or a particular business unit, project or product needs to address and mitigate. They also have an increasingly crucial role in providing oversight and guidance on their company's ability to respond to and be resilient in recovering from short-term or prolonged external crises and systemic shocks.

The reach and impact of these systemic risks and shocks range from global crises such as the Covid-19 pandemic and the 2008-2009 financial crisis to regional or location specific currency crises, conflict and natural disasters, a growing number of which are exacerbated by a changing climate. Despite obvious differences between the types of crisis and between locations and industry sectors, they share the common characteristic of being systemic in terms of their impact and beyond the control of any individual company to prevent.

The key question for Boards is how well is their company prepared to respond to such crises and how resilient is it in terms of its ability to survive the immediate aftermath and to recover, either by rebounding or fundamentally changing and adapting, over the medium- and longer-term? Three key areas for Board focus are:

- Improving preparedness
- Responding to and managing crisis
- Recovery options and future resilience.

#### A. Improve preparedness

The ability of a company to respond to and recover from an acute or systemic crisis is obviously determined by a number of external factors beyond the company's control. At the same time, the effectiveness of any response and recovery process also depends on the rigor and scope of the company's risk management systems and its crisis preparedness processes, combined with an adaptive and engaged corporate culture and the quality of leadership at both the executive and operational levels of the company. Boards should provide oversight and support to management in the following areas:

##### ***Undertake scenarios, stimulations and stress-testing***

As an ongoing process, Boards and management teams need to undertake more regular and sophisticated scenario analysis, horizon-scanning activities and crisis management simulations and planning to better understand the likelihood and potential impact of systemic risks resulting from technological, environmental, geo-political and socio-economic change. Linked to these, they need a better understanding of the potential systemic risks to their company as a result of changes in or stress on key systems such as financial, food, energy, health and trade systems. Such understanding is needed at both the global and enterprise level as well as operationally, especially in high-risk locations.

The practice of regulatory-led "stress-testing," has become common in the financial sector following the global financial crisis and more recently is being explored as an approach to assess business resilience in the face of climate-related risks.<sup>37</sup> This approach should be applied more widely as an internal corporate governance and management tool to help Boards and management assess their company's preparedness and resilience for different types of crisis and system-level shocks. Key pillars of the organization's preparedness that should be assessed include governance and leadership structures and key components of operational, financial, technological and cultural resilience.

##### ***Develop crisis succession plans for key executives and mission critical operators***

Rigorous succession planning remains crucial at any time, but deserves targeted Board attention as part of crisis management and contingency planning. Chair and CEO succession plans are obviously essential, but Boards also need to ensure there are succession plans in place and optionality for other members of the executive team and for 'mission critical' roles and functions at the operating levels of the company. These are the leaders who will be essential in responding to and recovering from a crisis, especially in situations where peoples' safety and wellbeing are at stake or where business continuity is being challenged either immediately or over a prolonged period of time. Alongside other executives, the human resource function has a critical place at the table on crisis preparedness and planning, and relevant Board Committees should review mission critical roles as well as executive succession plans on an ongoing basis.

“ Depending on the industry and location, there is usually a need to consider both internal asset deployment and stakeholder communications and engagement as well as external efforts. ”

##### ***Review deployment options for emergency response assets and relationships***

In addition to crisis leadership planning, companies should have plans in place at both corporate and operating levels for essential assets that may need to be rapidly deployed and key stakeholder relationships that may need to be mobilized in the event of a crisis. Depending on the industry and location, there is usually a need to consider both internal asset deployment and stakeholder communications and engagement as well as external efforts. From an internal perspective, the company needs to understand how essential physical and financial assets can either be moved or adapted to respond to a crisis as well as exploring alternative or back-up supply and distribution networks.

Companies that have products, services, digital platforms or physical logistics networks that are particularly important at times of a natural or man-made humanitarian disaster, have an additional responsibility to understand how these could best be deployed in a crisis. Leaders in the pharmaceutical, consumer goods, transport and logistics and information technology industries have longstanding experience in the latter, usually with Board oversight. All companies, however, should review their assets and relationships with a view to internal and external crisis response.

“**The Board should be available to serve as a sounding board and offer support, especially in the case of mission critical decisions, not overload management with constant demands for information or meetings.**”

## **B. Crisis management and response**

No matter how well prepared a company is, crises will happen; both acute, short-term crises affecting a particular location, business unit or key leader and more prolonged, systemic crises affecting the entire company. Boards need to be equipped to immediately respond to these. Sometimes this will require the Board or a senior non-executive director to step directly into an executive role, but more often it will require the Board to support its senior management team.

The need to distinguish clearly between the roles of management and the Board is probably greatest at the time of crisis management. Management teams will be working under intense pressure and time constraints, putting crisis response teams in place, implementing and often adapting existing crisis management plans, engaging with key stakeholders from employees, customers, suppliers and shareholders to communities and governments, depending on the crisis, and making a multitude of decisions, some of them mission critical. The Board should be available to serve as a sounding board and offer support, especially in the case of mission critical decisions, not overload management with constant demands for information or meetings.

Having said that, the following areas are important for Boards to consider in most crisis situations, especially more systemic shocks.

### ***Put people first***

This is crucial in a natural or humanitarian crisis, but also relevant in a sustained economic or financial crisis. A key question for Boards is how their company is ensuring the immediate safety and wellbeing of people in its operations and value chain? Depending on the type of crisis, what are the health, safety, financial and job implications for employees, customers, suppliers (especially small businesses), and people in the company's local communities. After addressing immediate health and safety considerations, how are the livelihoods and incomes of the company's stakeholders being effected – both by the crisis itself and by the decisions the company is having to make in terms of business continuity and financial liquidity? What can the company do on its own to support its employees and other stakeholders who are adversely affected, and what type of government support and social welfare or safety nets can the company access or advocate for on behalf of these people? Linked to all of the above, how effectively is the CEO and management communicating with key stakeholders?

In response to the Covid-19 pandemic, leading World Economic Forum representatives and members, including Klaus Schwab, Founder and Executive Chairman, Bank of America CEO Brian Moynihan, Siemens and Maersk Chairman Jim Snabe, and Royal DSM Hon. Chairman Feike Sijbesma, on Wednesday called on their peers to voice support for a set of “Stakeholder Principles” to manage the economic impacts from the public health emergency, and work towards economic recovery when the virus is defeated. These outline a set of principles and commitments that business leaders and Boards should make to their employees, ecosystem of suppliers and customers, end consumers, governments and society, and shareholders in helping them to respond to the crisis and build future resilience.<sup>38</sup>

The Forum has also produced additional guidance on Workforce Principles for the COVID-19 Pandemic.<sup>39</sup> And, Business Fights Poverty and the Corporate Responsibility Initiative at Harvard Kennedy School have developed a set of toolkits on how companies can support the most vulnerable people among their employees, workers, customers, small business partners and communities in response to this global humanitarian and economic crisis.<sup>40</sup>

### ***Support critical functions and operations for business continuity***

In some crises, business continuity will be impossible or seriously constrained, even if the company is not facing a liquidity crisis. In others, the focus will be on maintaining as much functional and operational capacity as possible to ensure safe and if possible productive and profitable operations can continue. Questions that need to be addressed include: the effectiveness of plans to ensure that mission critical leadership and operational roles are sustained and given the support they need; understanding the extent of disruption in the company's key supply chains and its own ability to supply customers and what flexibility and optionality is available to address these; how effectively is the company engaging and where possible partnering with key suppliers and customers to resolve bottlenecks and shortfalls; and what if any, are the trade restrictions and implications the company must address?

### ***Provide oversight of financial risks and resilience***

Closely intertwined with business continuity is the obvious risk of liquidity and other financial challenges. At times of crisis the Board and management team need to review their current capital allocation strategies and priorities, as well as their engagement with key investors and regulators. For example, should they be stopping share buybacks programmes, reviewing dividends and/or postponing capital projects? Are there opportunities to increase or at least maintain cost discipline? How proactively are the CEO and CFO engaging with investors? What actions should be taken to revise business plans and change operating and financial forecasts and guidance to the market? How can this be presented in a way that addresses the immediate crisis and outlines longer term resilience and recovery potential if possible? Are there crisis-related risks from activist shareholders or potential hostile takeover bids? From a compliance perspective, what, if any, different financial reporting and disclosure requirements



need to be met in the immediate aftermath of a crisis and how is the company working with its auditors and legal advisers on addressing these? Are there tax implications and/or government support funds and incentives that can be accessed to help address immediate financial losses and manage ongoing risks?

### **C. Focus on recovery and future resilience**

The period, intensity and global scope of a crisis management situation will obviously vary depending on the nature of the crisis and how systemic it is. As soon as possible, however, the Board and management team should be reviewing medium and longer-term recovery plans and discussing lessons learned to strengthen the company's resilience for the future.

#### ***Start reviewing recovery options and strategy as early as possible***

Boards should stay focused on the company's strategy and be ready to support management as they implement ramp-up options if business activities have been slowed or closed down due to a crisis. More importantly, following a crisis, there may need to be changes or even a transformation in the company's policies and operating procedures, risk management systems, capital allocation priorities and even its core business strategy. Particular markets or industries may have changed fundamentally, and there may be new risks and opportunities emerging for the company as a result. After transitioning out of a crisis management phase, there is a unique opportunity for the Board and management team to review, and where needed to either refresh or transform each of the above areas.

#### ***Build future operational, cultural, financial and technological resilience***

Linked to the above, crises nearly always provide useful lessons for improving risk management and stakeholder engagement. More broadly, they often point to the need and opportunity to strengthen a company's resilience; its ability to respond to and recover from future crises. Even in the absence of a crisis, the nature of the technological, environmental, geo-political and social shifts underway is placing a greater premium on the concept and practice of resilience as a crucial and more strategic element of effective risk management. Research by a variety of practitioners and academics points to the need for Boards and management to review resilience through the combined lenses of – operational, cultural, financial and technological capabilities and abilities to withstand systemic risks and shocks.

Building long-term and trusted relationships with external stakeholders is another important element in building resilience. At times of crisis, these relationships can be key to the company and its employees, customers, business partners and communities being able to respond and recover. And they usually need to be built over time.

As previously outlined, applying the concept of 'stress-testing' to these different aspects of resilience offers potential. Likewise with Boards and management jointly undertaking scenario analysis and crisis simulation exercises. In the same way that Boards are taking a more proactive role in engaging in strategy and long-term value creation discussions with management, there is an opportunity for a more systematic and regular Board-level discussion around strengthening business resilience.

“ In the same way that Boards are taking a more proactive role in engaging in strategy and long-term value creation discussions with management, there is a need for more systematic Board-level discussions around strengthening business resilience. ”

#### 4. Engage the firm in cooperative efforts to strengthen its operating environment

Good corporate governance in the age of the Fourth Industrial Revolution and growing societal expectations of business also requires recognizing that companies have a more important stake than ever in the health of their operating context – in the essential functioning of the societies and economies in which they operate. Their practices and operations can have an important impact in this respect, either positive or negative. Four critical dimensions of a firm's shared stewardship of its operating context include the following: the capacity of people in the firm's communities to absorb and manage economic change; the quality of public institutions to provide public goods on which all societal actors, including companies, depend; joint efforts to tackle structural inequality and injustice; and the relevance of the firm's core competencies and resources to its national government's priorities in implementing the SDGs.

##### ***Collective investment in human capital and a just transition***

First, one of the principal weaknesses, even failings, of corporate and public governance during the past generation has been an underappreciation of and underinvestment in the human costs of rapid economic change, such as addressing major shifts in skills, jobs and training needs. This challenge is likely to intensify in the Fourth Industrial Revolution and Globalization 4.0 as automation spreads, global markets become more digitally interconnected and actions to decarbonize economic activity intensify. Companies will be the primary vehicles of these economic changes, which means they will face important decisions with regard to the timeline and nature of the corresponding restructuring and redeployment of their workforces and making human capital investments in the communities or regions where they operate.

“A new dimension of corporate governance requiring attention from Boards is the need to identify salient just-transition risks related to automation, restructuring, climate change abatement or other plans.”

In the absence of an understanding of what constitutes a just transition for people and a strategy to make such a transition as humane and economically orderly as possible in cooperation with workers, governments and other stakeholders, companies may inflict severe yet avoidable damage on the social fabric of the communities and countries in which they operate. This could ultimately affect the political stability and economic viability of that context, limiting the company's own prospects for value creation and growth. Accordingly, a new dimension of corporate governance requiring attention from Boards is the need to identify salient just-transition risks related to automation, restructuring, climate change abatement or other plans and to ensure that management has adequate policies and practices for mitigating them.

To help in this regard, the Forum's [Closing the Skills Gap](#) project has issued a call for measurable commitments from leading companies around the world to train, reskill and upskill the current and future workforce. The project has created a global community of experts and leaders in education and training, and it is establishing a network of national public-private platforms to close skills gaps and reshape education and training for the future. To date, businesses have committed to reach over 17.2 million people through training, reskilling and upskilling by 2020. This surpasses the goal of covering 10 million people by 2020 set at the World Economic Forum Annual Meeting 2018. Each business commitment helps drive impact to close current skills gaps and reshape education and training for the future.

“One of the principal weaknesses, even failings, of corporate and public governance during the past generation has been an underappreciation of and underinvestment in the human costs of rapid economic change.”

##### ***Payment of corporate tax to support public goods and services***

Second, government tax bases have come under further pressure, as digitization, deregulation, trade liberalization and global value chains have increased the economies of scale and geographical fragmentation of production as well as the capital share of national income in many countries. Long-term economic value creation requires functioning public institutions in a wide variety of domains, and these depend on adequate public finances.

Thus, companies have not only a legal obligation to pay taxes, but also a broader fiduciary responsibility stemming from their long-term value-creation mandate to ensure that they pay their fair share, which may not always be the same amount as that resulting from aggressive, multijurisdictional tax planning. Boards have a responsibility to ensure that their firms are acting not only legally but also in keeping with the trust society has placed in them to contribute fairly and responsibly to the long-term viability of the economy in which they operate.

The OECD's Inclusive Framework on Base Erosion and Profit Shifting brings together over 115 countries and jurisdictions to collaborate on the implementation of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Package. BEPS refers to tax-planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations where there is little or no economic activity. Although some of the schemes used are illegal, most are not. The BEPS Package provides 15 actions that equip governments with the domestic and international instruments needed to ensure that profits are taxed where the economic activities generating the profits are performed and where value is created. These tools also give businesses greater certainty by reducing disputes over the application of international tax rules and standardizing compliance requirements.

In addition, the Global Reporting Initiative has recently issued a new [global standard](#) for public reporting on tax payments by corporations. The standard contains three management approach disclosures and one topic-specific disclosure on country-by-country reporting. The combination of management approach disclosures and country-by-country reporting gives insight into an organization's tax practices in different jurisdictions. Boards should have oversight of these practices, including transparency and reporting.

### **Tackling structural inequality and injustice**

Third, in many countries, deep-seated inequality and injustice persist, even after changes in regulation, government policies, business practices and social norms. Although capitalism, globalization and market-based solutions have helped lift several billion people out of extreme poverty over the past few decades, in too many cases inequality has increased in terms of asset accumulation and wealth creation, access to jobs and essential services such as education, health, and housing, and access to criminal and social justice and political voice. The Covid-19 crisis has highlighted and exacerbated many of these existing structural inequalities and hundreds of millions of people risk falling back into poverty as a result of the pandemic's devastating impact on their health and food security, their livelihoods, jobs and income and their education and learning. Governments must take the lead in addressing these issues, but there is a growing expectation among employees, consumers, activists, the general public and even investors and governments themselves that business, especially large companies, should play a more proactive role in tackling inequality and injustice.

At a minimum, there is the growing expectation that companies should be responsible for and held accountable for the impact of their own operations and business relationships in terms of respecting human rights, workers' rights and civil rights and promoting diversity and inclusion in their own workplaces and global value chains. That they should be paying fair taxes and investing in a just workforce transition, as outlined in the previous sections. At the same time, pressure is growing for companies to pay and become champions for adequate minimum wages and the goal of living wages for their immediate employees and workers along their global supply chains. Improving access to paid sick leave, health insurance and other benefits for low-income, low-skilled and/or temporary, contractual and gig economy workers is another area of increased focus.

Beyond their own business operations, there are growing demands for business leaders to step up, both individually and collectively, to help address systemic and structural obstacles to overcoming inequality and injustice. This could range from efforts to support specific government or community-based programs focused on improving access to education, healthcare, housing and economic opportunities to companies getting more engaged in advocacy for public policy reforms and institutional changes such as better social safety nets, access to universal health, direct cash transfer mechanisms and criminal justice reform.

None of this is easy, especially in periods of economic crisis, but these are issues that corporate Boards and executive teams need to increasingly understand and have a position on in the countries and communities in which they operate.

### **Contribution to the Sustainable Development Goals**

Fourth, the Paris Climate Agreement and the agreed SDGs established by the United Nations in 2015 are being translated by national governments into specific plans and policy priorities. The Business and Sustainable Development Commission has concluded that achieving the Global Goals has the potential to generate up to \$12 trillion of opportunities in 60 different market segments within four economic systems: food and agriculture, cities, energy and materials, and health and well-being. As such, the SDGs represent an enormous growth opportunity for businesses, including through strengthening their operating context.

Accordingly, Boards focused on long-term economic value creation should embrace the commission's recommendations to incorporate aspects of the Global Goals relevant to their firm's core competencies and markets into their company strategy and operations. This includes appointing senior executives and identifying Board champions to prioritize and drive execution as well as working with peer companies and other stakeholders to drive the enabling environment improvements and investments that can affect the necessary transformation of economic systems. In line with the theme of its 50th Annual Meeting, *Stakeholders for a Cohesive and Sustainable World*, the Forum and its International Business Council have prepared a [report](#) that presents over 150 concrete examples of such multistakeholder and corporate "lighthouse" projects. These are open for engagement and replication by Forum Member companies and other stakeholders.

One of the greatest impediments to achieving the Paris agreement and the Global Goals are systemic shocks and crises. These range from global crises, such as the 2008 global financial crisis and the Covid-19 pandemic, to regional and local conflicts, natural disasters and currency crises. Evidence suggests there will be an increase in the frequency and humanitarian and economic costs of these crises, due to challenges ranging from climate change and growing inequality to fragility of trade and financial systems. Boards should engage with management to review not only their own company's preparedness and resilience in the face of such threats, but also to assess if their company should be partnering with host governments and communities to strengthen the resilience of crucial institutions, infrastructure and systems more broadly in the countries and communities where they operate.

**“ ...The Sustainable Development Goals (SDGs) represent an enormous growth opportunity for businesses, including through strengthening their operating contexts. ”**

## 5. Prepare the company's mainstream reporting in an integrated manner

Integrated reporting and integrated corporate governance go hand in hand. The increased financial materiality of ESG&D factors requires well-governed corporations to reflect them in their mainstream disclosures – e.g. their annual reports to investors, including as appropriate in the statement of accounts and management discussion and analysis and proxy statements. In many cases, companies are aligning their annual financial reports and annual sustainability reports as another approach to providing investors and other stakeholders with clear performance metrics and analysis of risks and future goals. Ensuring that the company's disclosure of its sustainability metrics and performance is independently assured by an external third party is another step that Boards can take towards a more integrated approach to reporting.

The mainstream reporting of corporate ESG&D risk, strategy and performance remains at an early stage but is evolving rapidly. A number of efforts are under way to drive this agenda forward. They include:

- **The International Integrated Reporting Council** has developed a principles-based framework to help companies think about their reporting strategy in an integrated fashion and develop their own approach spanning various reporting formats, mainstream and otherwise.
- **The Sustainability Accounting Standards Board** has created a set of key performance indicators that serves as a standard for quantitative reporting of material aspects of a company's environmental and social sustainability, along with materiality maps for companies in 77 different industry sectors.
- **The Climate Disclosure Standards Board** has issued a standard to guide the reporting of material natural capital-related aspects of corporate performance, strategy and risk – i.e. both qualitative and quantitative material information – in mainstream reports.
- **The Global Reporting Initiative** issued the first global standards for sustainability reporting, which are designed to be used by any organization that wants to report on its impacts and how it contributes towards sustainable development. They encourage and enable credible non-financial reporting by companies and also provide sector-specific guidance.
- **CDP** is the foremost global platform for the disclosure of climate and other environmental data by companies, investors and other stakeholders.
- **The Human Rights Reporting and Assurance Frameworks Initiative (RAFI)** and the UN Guiding Principles Reporting Framework provide guidance for companies to report on salient human rights issues.

- **The Corporate Reporting Dialogue** has been facilitating a dialogue among these ESG standards and financial standard setters to advance progress towards a system that better captures and integrates financial and non-financial performance and strategy.
- **The Impact Management Project (IMP)** is a forum for organisations to build consensus on how to measure, compare and report impacts on environmental and social issues. It convenes a Practitioner Community of over 2,000 organisations to debate and find consensus (norms) on impact management techniques, and it facilitates a collaboration of organisations are coordinating efforts to provide complete standards for impact measurement, management and reporting.

“ **The Forum's International Business Council . . . is developing a core set of ESG&D metrics and reporting requirements, drawn wherever possible from existing standards.** ”

In an effort to accelerate progress towards a more harmonized and globally comparable system for disclosure of material ESG&D information, the Forum's International Business Council of approximately 140 large multinational firms is developing a core set of ESG&D metrics and reporting requirements in collaboration with the four largest accounting firms, drawing wherever possible from existing standards such as those referenced above. They issued a draft proposal for consultation, *Toward Common Metrics and Consistent Reporting of Sustainable Value Creation*, in January 2020. Their goal is to begin reporting collectively in line with these common metrics in their mainstream disclosures in the hope that this could help spur progress towards a more generally accepted global standard for this purpose.

The proposed metrics and disclosures have been organized in four pillars that are aligned with the SDGs and principal ESG domains: Principles of Governance, Planet, People and Prosperity. At the heart of the exercise is the belief that ESG and other factors relevant to sustainable value creation are increasingly material to business performance. As such, they should be addressed in the mainstream report and proxy statements and integrated into core business strategy and governance processes. By reporting on these factors on a consistent basis in its mainstream report – including a discussion of their implications for company strategy and governance – a company demonstrates to its shareholders and other stakeholders that it diligently weighs all pertinent risks and opportunities in running its business, conducting its governance processes and contributing to broader economic and social progress, including achievement of the SDGs.

The absence of a generally accepted international framework for the reporting of material aspects of ESG and other relevant considerations for long term value creation contrasts with the well established standards that exist for reporting and verifying financial performance. The existence of multiple ESG measurement and reporting frameworks and lack of consistency and comparability of metrics were identified as pain points that hinder the ability of companies

to meaningfully and credibly demonstrate the progress they are making on sustainability, including their contribution to the SDGs. The IBC companies are seeking to begin reporting consistently on a core set of metrics in an effort to encourage greater cooperation and alignment among existing standards as well as to catalyse progress towards a systemic solution such as a generally accepted international accounting or other reporting standard in this respect.

## Summary Overview of Core Metrics and Disclosures

Pillar	Theme	Sub-themes, Core Metrics and Disclosures
Principles of Governance	Governing Purpose	Setting purpose
	Quality of Governing Body	Board composition
	Stakeholder Engagement	Impact of material issues on stakeholders
	Ethical Behaviour	Anti-corruption
		Protected ethics advice and reporting mechanisms
Risk and Opportunity Oversight	Integrating risk and opportunity into business process	
Planet	Climate Change	Greenhouse Gas (GHG) emissions
		TCFD-aligned reporting on material climate risks and opportunities
	Nature Loss	Land use and ecological sensitivity
Fresh Water Availability	Fresh water consumption in water stressed areas	
People	Dignity and Equality	Gender pay equality (%)
		Diversity and inclusion (%)
		Wage level (%)
		Risk for incidents of child, forced or compulsory labor (#, %)
	Health and Well Being	Health and safety (%)
Skills for the Future	Training provided (#)	
Prosperity	Wealth creation and employment	Net number of jobs created
		Net Economic Contribution
		Net investment
	Innovation in better products and services	R&D spend ratio (%)
	Community and social vitality	Community investment (%)
Country by country tax reporting		

See Consultation Draft for further details.

## 6. Adapt the Board's organization, composition and engagement to these imperatives

Boards need to evaluate whether their current organization, composition and stakeholder engagement mechanisms are appropriate for the task of providing oversight for the integration of ESG&D issues into boardroom discussions and decisions on topics such as corporate purpose, strategy, capital allocation, risk management, succession planning and the oversight of management performance, as well as on balancing short-term performance with long-term value creation.<sup>41</sup> There are obvious differences between ownership structures and corporate governance models in different countries and jurisdictions that have an impact on how effectively these issues can be integrated, but some important factors and good practices for all Boards to consider include the following:

### A. Board organization

A core question to consider is the appropriate allocation of discussions and decision-making on ESG&D risks and opportunities between the full Board and relevant committees. It is no longer an either/or situation. In every industry sector, ESG&D issues are now so material that they must be addressed by the full Board. At the same time, the range of issues that are likely to be material in any large company – from human rights, ethics and employee safety to climate change, water management and data stewardship – are sufficiently wide-ranging and technically complex and sophisticated that their oversight requires more time than can be allocated in most Board meetings. As such, there is a growing need to ensure that relevant Board committee charters also include oversight of these issues. This includes a regular review of which ESG&D-related issues need to be addressed by which committee. The appropriate balance will vary, depending on the industry sector, corporate law and disclosure requirements in the head-office country and current Board structure. The key point is for Boards to be intentional and systematic about how they integrate ESG&D issues into their core oversight roles and responsibilities.

#### *Integrating ESG&D at the full Board*

In many companies, an annual presentation on ESG&D issues is now made to the full Board. This is necessary but not nearly sufficient in most large companies that are operating globally. It is important for the full Board to have an annual overview of the ESG&D issues that management considers to be most material to the company and salient to people and the environment, along with changes in stakeholder expectations and the company's policies, standards, strategies and due-diligence processes for managing these risks and opportunities and its performance against targets. In addition, it is increasingly necessary to consider these issues in the context of other key Board oversight topics and functions. For example:

- **Approval of corporate purpose:** As a growing number of governance practitioners, advisers and academics are noting, the full Board of Directors should have input into approving the company's purpose. Although it is the role of management to lead the work on developing a company's vision, mission, values and purpose, preferably in a way that actively engages employees, the Board should be engaged. In particular, it has a role in approving the company's purpose and discussing the implications of this purpose statement for how the company operates, what its key goals or performance indicators are and how management is incentivized and compensated for achieving them. If a contribution to society or stakeholders beyond maximizing shareholder value is an explicit part of the company's publicly stated purpose, this in turn sets the foundation for integrating material ESG&D issues into core business activities.

“ Ideally, ESG&D-related issues should be one or more of the pillars of the corporate strategy itself. ”

- **Corporate strategy discussions and strategic pillars:** At a minimum, Boards should be asking how ESG&D issues may either undermine, support or in some cases drive a company's strategy and key goals. In addition, the company's sustainability or corporate responsibility strategy should be directly aligned with its corporate strategy. Ideally, ESG&D-related issues should be one or more of the pillars of the corporate strategy itself. Since both executives and management are usually incentivized and compensated based on their performance against the company's strategy, the greater the integration of ESG&D issues, the more likely they are to influence behaviour and results.
- **Enterprise risk management and risk tolerance discussions:** Every Board should be engaged in a regular review of the company's enterprise risk management system, and understand how material ESG&D risks are being integrated, ranked and managed alongside other risks. In addition, ESG&D risks should be one of the topics addressed in Board discussions on the company's risk appetite and tolerance.
- **Business planning, target setting and business unit performance:** Linked to the above, if ESG&D issues are an explicit part of a company's strategy, they will also be integrated into business planning, target setting and performance review processes, and the Board's approval of these. To the extent that this cascades from the corporate level to operating units – be they different lines of business, different brands or different geographies – the more likely that the company will be well positioned to understand and manage key ESG&D risks and opportunities.

- **Major investment decisions, research and business development:** ESG&D risks and opportunities should be integral to competitive analysis and to the scoping, feasibility assessments, due diligence and decision-making associated with major investments and business development activities, such as mergers and acquisitions and new market entry. In many industry sectors and companies, these risks and opportunities are also increasingly material to decisions and investments made in research and development (R&D). They can be a key driver of innovation in new science and technologies as well as a consequence of such innovation, both intended and unintended and both positive and negative. As such, the full Board needs to understand and debate both specific ESG&D risks and opportunities and broader scenarios or potential systemic outcomes associated with major investments, R&D and business development decisions.
- **CEO and executive compensation and succession planning:** Boards play a crucial role in the oversight of CEO performance, compensation and succession planning. In a number of cases, this oversight extends to the senior executive team more broadly. Ensuring that the ability to manage ESG&D risks and opportunities is part of the skills matrix for the CEO and relevant executives, and that targets for ESG&D performance are included in performance review, incentive and compensation programmes, is an essential factor in embedding good practice.
- **Public reporting and disclosures:** In the same way that Boards and their audit committees review and approve a company's financial statements, leading Boards are also starting to review and approve their company's sustainability or ESG&D materiality assessments, targets, reports and disclosures. Detailed review and oversight are usually most effectively undertaken at a committee level, but the full Board should be informed of the company's public disclosures on ESG&D related policies, commitments and performance.
- **Corporate culture:** The focus on the role of Boards in both contributing to and monitoring corporate culture is growing. All the values and purpose statements, ethical policies and standards in the world will not be effective if the company's culture and, linked to that, its role models, accepted behaviours, incentive systems and rewards are not aligned to these statements and policies. Indeed, failure to "walk the talk" is a key driver of declines in employee morale and productivity, and stakeholder trust more widely. Boards have an increasingly important role to play in "setting the tone from the top" and ensuring the rigorous monitoring of relevant training and awareness programmes, employee engagement surveys, whistleblowing mechanisms and culture reviews, in addition to demonstrating zero tolerance for harassment or harmful and unethical behaviour.

### ***Embedding ESG&D into Board committee charters***

As outlined above, the range of material ESG&D issues that need to be addressed by many companies and the technical complexity of some of these issues, most notably in the areas of digital and other new technologies and climate change, increasingly require the additional time and attention of a Board committee. There is no one-size-fits-all. It is up to the Board and, if it has one, a governance committee to determine how to allocate ESG&D issues at the committee level. Options include the following:

- **A dedicated committee focused on ESG issues:** A growing number of corporate Boards have established a committee dedicated to addressing ESG, corporate responsibility, safety and sustainability or public affairs issues. Such committees are able to provide regular oversight of the company's key risks, opportunities and performance with respect to its most material ESG issues; review global strategies for these most material ESG issues, i.e. employee health and safety, climate and energy, water, human rights, etc.; provide input to materiality and salience analysis and the company's public disclosures related to these issues; and appoint expert advisers or reviews to address specific ESG-related challenges or crises. In some cases, geopolitical risks, government relations and other external stakeholder engagement are also a focus of such committees.
- **A broader risk committee:** In other cases, Boards are establishing a dedicated risk committee to provide oversight of a broader range of material risks to the business. These may include ESG-related as well as other material risks, such as data stewardship, technology more broadly, geopolitics, and other business continuity and industry disruption risks.
- **A science, technology and innovation committee:** Some companies, especially in research-led, science and technology industries, are establishing science, technology and/or innovation committees to stay on top of key scientific and technology trends and disruptions and to provide better insight and oversight on key science and technology-related risks and opportunities faced by the company. Some of these will be ESG&D related or will have implications for the company's performance on ESG&D issues.
- **The integration of ESG&D into other committees:** In many cases, even with a dedicated ESG or risk committee, other more traditional committees also have responsibility for oversight of key ESG&D-related risks and opportunities.

The *audit committee*, for example, should be reviewing the company's ethics compliance, anti-corruption and integrity policies, systems and performance and, in some cases, its data stewardship systems. It should also be discussing and, where relevant, disclosing the financial risks associated with material ESG&D issues.

*Compensation committees* in many Boards are expanding their mandate and their name to encompass leadership development, talent management and inclusion and diversity, alongside their traditional compensation oversight responsibilities. Such committees can play a crucial role in ensuring the clear alignment of executives' performance incentives and rewards with ESG&D performance, alongside their financial, commercial and operational performance. They can also provide oversight of ESG&D integration into the company's human capital strategies more broadly.

*Governance and nominating committees* can play an essential role in ensuring that ESG&D-related skills, capabilities and experiences are integrated into director recruitment, onboarding, training and succession planning, as well as having oversight of committee charters and Board peer reviews and evaluation processes.

## **B. Board composition**

Board composition or membership is as important as Board organization. In today's complex, multistakeholder, multicultural and multinational operating environment, there is growing recognition of the need for greater Board diversity – diversity not only in terms of gender and race, although both are essential, but also diversity in background, experiences, skills, nationality and age.

The foundations of a strong Board are well understood. Every Board needs experienced directors who have extensive governance, executive and operating experience, both in the industry in question and in other industries that may offer different, but valuable insights and lessons. In the wake of various financial scandals and crises, it is clearly essential for every Board to have a sufficient number of directors with the relevant financial, accounting and auditing skills.

At the same time, a growing imperative in many Boards is to have directors with the technical and/or risk management skills and experiences needed to understand the massive technological disruptions and digital, data stewardship and other technology-related risks that companies are facing. Bringing one or two technically skilled younger directors on board can help in this area, as well as providing insights from a younger generation of leaders. Companies operating globally benefit from directors who live in and/or have worked in some of their most important countries or regions of operation, or a director who has extensive geopolitical and diplomatic experience in relevant areas of operation. And, increasingly, there is a focus on appointing directors who bring operational or academic skills and experiences related directly to understanding the company's evolving ESG risks and opportunities.

There is the obvious need to balance the expanding range of necessary experiences, skills sets and mindsets with ensuring that the Board is not too large for effective discussions and decision-making. As such, director recruitment and succession planning need to focus on finding directors who, on an individual basis, can meet a diverse matrix of skills requirements and backgrounds. Certainly, more and more former CEOs and other senior executives are well versed in managing ESG&D-related risks and opportunities, and this should be one of the skills or experience sets to look for in all director recruitment. In addition, structured and staggered succession planning, alongside term or age limits, can help to ensure that a Board balances the need for "institutional memory" with fresh perspectives and generational change in a rapidly evolving and often disruptive operating environment.

## **C. Board engagement**

In addition to the ongoing rigorous review of Board organization and composition, Boards need to understand and discuss the evolving boundaries of their engagement with stakeholders, both internally and externally. The growing focus by large institutional investors on stewardship and engagement and increasing calls for stakeholder capitalism suggest that Boards need to, at a minimum, have a clear understanding of their company's key stakeholders. Such an understanding needs to be at a much more granular and nuanced level than the broad categories of shareholders, employees, customers, suppliers and communities. At the same time, both shareholders and other stakeholders are demanding more engagement directly with Boards. In almost all cases, executive management should take the lead on both internal and external stakeholder engagement, bringing non-executive and independent directors in when there is a specific need or request to do so.

### ***Internal stakeholders***

In many companies, non-executive directors are exposed only to the CEO, CFO and her or his Executive Leadership team. Such engagement is obviously crucial and at the heart of good corporate governance – aiming to achieve a healthy balance of rigorous oversight, questioning and challenging of management with mutual respect and a shared focus on the best long-term interests of the company. Having the full senior executive team attend all Board meetings is an approach some leading companies are taking to ensure more holistic and robust oversight and discussions between the Board and all the senior executives who are responsible for delivering on the company's purpose and strategy and managing enterprise risks.

From an ESG&D perspective, having the executive who is responsible for these issues attend all Board meetings, and not just delivering an occasional presentation on ESG&D topics, is another way to help integrate these issues in the boardroom. Some companies are also establishing a senior-level ESG or sustainability committee, composed of operational and functional executives, that reports to the Board as part of the company's governance process.



In addition to regular engagement between the Board and the full senior executive team, other approaches that companies are taking to ensure their Boards have a better understanding of the company's risks, opportunities and culture are to organize regular operational or research site visits and opportunities to engage with employees through participating in either large townhall meetings or smaller group discussions. These approaches can give Boards exposure to business unit or country and operational site managers, front-line supervisors, researchers, high potential young managers and the leaders of business resource, affinity or diversity groups.

“The number of independent Board chairs and committee chairs who meet with shareholders or other external stakeholders is growing.”

### ***External stakeholders***

In addition to the CEO, CFO and other executives, the number of independent Board chairs and committee chairs who meet with shareholders or other external stakeholders is growing. Some companies are also establishing external ethics, technology, sustainability or country-focused advisory councils that provide regular input to senior management and engage with relevant Board directors or Board committees on some of the company's most material ESG&D issues.

In summary, a number of changes are under way to integrate the oversight of ESG&D risks and opportunities at the Board level through changes in Board organization, composition and stakeholder engagement mechanisms. In companies with good corporate governance, this remains a dynamic and ongoing process aimed at ensuring that Board directors are well informed and equipped to meet their fiduciary duties and duty of care to the companies, shareholders and stakeholders they serve.

### III. Conclusion

This White Paper presents an agenda for updating and upgrading corporate governance in line with the ongoing technological, environmental, geopolitical and socio-economic transformation of today's business operating context.

To be certain, public governance also needs updating and upgrading. But companies and their Boards can do much on their own to improve the sustainability, inclusiveness and dynamism of economies while improving their own capacity to generate ongoing economic value and profits. Society – and particularly Millennials and younger generations – is already mobilizing and insisting on such change. Boards need to be ahead of or at least on this curve rather than behind it.

**“ The framework is relevant whether a company is chartered as a for-profit or for-benefit enterprise, and across diverse types of public, private and state ownership. ”**

Stakeholder capitalism offers a vision of corporate governance transformation in the 21st century. But the principles to this effect outlined in Section I will need to be translated into action on a company-by-company and Board-by-Board basis to become reality. This paper has outlined a conceptual framework and practical roadmap for doing so by integrating ESG&D factors in core business strategy and Board governance processes. The framework is relevant whether a company is chartered as a for-profit or **for-benefit** enterprise, and across diverse types of public, private and state ownership.

This is how Boards wishing to position their firms for success in the Fourth Industrial Revolution can transcend the concepts of shareholder primacy and corporate responsibility, integrating them in a manner that produces sustained and shared economic value that benefits shareholders, stakeholders and society.

**“ Boards wishing to position their firms for success ... can transcend the concepts of shareholder primacy and corporate responsibility, integrating them in a manner that produces sustained and shared economic value that benefits shareholders, stakeholders and society. ”**

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